107 FERC ¶ 61,175
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations — Docket No. EL01-118-003

ORDER ON REHEARING

(Issued May 19, 2004)

1. Intervenors seek rehearing and clarification of the Commission's November 17, 2003 order in which we adopted certain Market Behavior Rules and related procedural guidelines applicable to sellers' market-based rate tariffs and authorizations.[1] For the reasons discussed below, we deny rehearing and grant, in part, and deny, in part, intervenors' requests for clarification.

Background

2. In the order that initiated this proceeding, on November 20, 2001, we proposed to condition all new and existing market-based rate tariffs and authorizations to include a prohibition against "anticompetitive behavior" and the "exercise of market power."[2] We issued this proposal, in the form of a proposed pro forma tariff provision, to address on an industry-wide basis the types of market abuses that had occurred in the western markets during 2000-01, which were only then being uncovered in our then-pending investigation of these markets.[3]

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[1] Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 FERC ¶ 61,218 (2003) (Market Behavior Rules Order).

[2] See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 97 FERC ¶ 61,220 (2001).

[3] For a summary of the actions taken by the Commission in response to these market conditions, see generally San Diego Gas & Electric Company, et al., 96 FERC ¶ 61,120 (2001).

3. Numerous responsive pleadings were filed in response to our proposal. Commenters asserted, among other things, that a general prohibition against anticompetive behavior and the exercise of market power, alone, without greater specificity, would provide inadequate protection to market participants while giving sellers insufficient notice of the specific conduct our rule would require or prohibit. Commenters also questioned the extent to which the events then being investigated in the western markets provided an appropriate justification for new standards of conduct applicable to sellers in other markets.

4. In March 2003, Commission Staff issued its Final Report on the western markets in which it found that, absent clearly-stated behavioral standards governing sellers' conduct in the wholesale electricity markets, many of the market abuses found to have been committed in the western markets could also be committed by sellers in other markets.[4] Commission Staff therefore recommended that the Commission adopt a number of specific market rules applicable to sellers on an industry-wide basis.

5. Based on these recommendations and the comments filed in response to our initial proposal in this proceeding, we issued an order on June 26, 2003, in which we set forth, as a modified proposal, six proposed Market Behavior Rules.[5] In this modified proposal, we addressed with greater specificity than we had in our initial proposal, behavioral standards covering: (i) sellers' unit operation; (ii) market manipulation; (iii) communications; (iv) price reporting to index developers; (v) record retention; and (vi) related tariff matters. We also proposed that any seller found to have engaged in the behavior prohibited by our Market Behavior Rules be subject to a disgorgement remedy and any other appropriate non-monetary remedies such as revocation of seller's market-based rate authority.

6. Numerous comments were filed in response to our modified proposal. In the Market Behavior Rules Order, we found that intervenors largely supported the Commission's overall objectives in this proceeding and the general thrust of our proposed rules and procedural guidelines. However, we also noted that we had received a number of constructive suggestions for fine-tuning the specific requirements embodied in our rules. Accordingly, we adopted our proposed Market Behavior rules, subject to certain

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[4] See Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 (March 2003) at ES-14-17.

[5] See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 103 FERC ¶ 61,349 (2003)(June 26 Order).

modifications and clarifications, to become effective December 17, 2003.[6] We also adopted our proposed procedural guidelines, subject to modifications and clarifications, and addressed the application of our rules, as they relate to market monitoring matters, in the organized markets operated by regional transmission organizations (RTOs) and independent system operators (ISOs).

Requests For Rehearing and Clarification

7. On rehearing, intervenors renew a number of claims addressed in our prior orders in this proceeding, relating to the proper scope and interpretation of our Market Behavior Rules. In addition, intervenors renew numerous challenges regarding the procedural guidelines applicable to our rules and continue to challenge the legal findings made by the Commission both in the June 26 Order and in the Market Behavior Rules Order regarding the asserted vagueness of our rules and the Commission's statutory authority to approve these rules under Section 206 of the Federal Power Act (FPA).[7] As discussed below, the majority of these rehearing requests seek to either lessen, or even negate, the impact of our rules on sellers or, conversely, seek to broaden the scope of sellers' potential liability, or propose additional, stiffer sanctions against sellers found to be in violation of these rules.

Discussion

8. For the reasons discussed below, we will deny rehearing of the Market Behavior Rules Order. In doing so, we reaffirm here the careful balance struck by our rules -- between the rights of the individual seller, on the one hand, and the needs of market participants and the marketplace as a whole, on the other. As we have stated before and reiterate here, while sellers need to be given rules of the road that are clearly delineated, market participants must be given an effective remedy in the event anticompetive behavior or other market abuses are found to have occurred. While sellers need and deserve regulatory certainty in the form of rate certainty and transaction finality, the Commission, in the performance of its statutory duties, cannot be impaired in its ability to provide remedies for market abuses whose precise form and nature cannot be envisioned

[6] In a companion issuance, we also modified natural gas market blanket certificates under subpart G of Part 284 of the Commission's regulations to contain many of the standards proposed in this proceeding, where applicable. See Final Rule, Docket No. RM03-10-000, Amendments to Blanket Sales Certificates, 105 FERC ¶ 61,218 (2003), order on reh'g, 107 FERC ¶ 61,174 (2004).

[7] 16 U.S.C. § 824e (2000).

today. As we discuss in greater detail, below, our Market Behavior Rules strike this necessary balance in a way that will both protect market participants and promote competition in the wholesale electricity markets.

A. Due Process Requirements

The Market Behavior Rules Order concludes, as did the June 26 Order, that the Commission's Market Behavior Rules, including specifically the prohibitions set forth in Market Behavior Rule 2 (relating to market manipulation) are not unduly vague or overbroad.[8]

1. Requests for Rehearing

9. Cinergy Services, Inc. (Cinergy), Duke Energy Corporation (Duke), Puget Sound Energy, Inc.[9] (Puget Sound, et al.), Merrill Lynch Capital Services, Inc. and Morgan Stanley Capital Group Inc. (Merrill Lynch and Morgan Stanley), and Mirant Americas Energy Marketing, L.P. and Williams Power Company, Inc. (Mirant and Williams) argue that the Commission's Market Behavior Rules, including, in particular Market Behavior Rule 2 (our anti-manipulation standard) and its subparts, violate due process requirements. Specifically, these intervenors assert that our Market Behavior Rules are impermissibly vague and overbroad and, thus, do not give adequate notice of the behaviors they may prohibit or the actions they may require.

10. Cinergy suggests, for example, that the meaning of the term "without a legitimate business purpose," as employed in the preamble requirement of Market Behavior Rule 2, remains entirely undefined, despite the Commission's best efforts in the Market Behavior Rules Order to give this term sufficient meaning. Cinergy notes that the Commission's attempted clarifications of this term were themselves vague and ambiguous because, among other things, the terminology relied upon by the Commission has no commonly accepted meaning within the industry and it otherwise the subject of ongoing debate as to its meaning in a given case.[10]

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[8] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 163-174.

[9] Joined by Avista Corporation and Avista Energy, Inc.

[10] Cinergy Request for Rehearing at 5-6 (citing the Commission's reliance on the terms "manipulative conduct" and "transactions without economic substance" in explanation of its term "without a legitimate business purpose.").

11. Cinergy also states that while the Commission deleted from Market Behavior Rule 2 the term "market prices which do not reflect the legitimate forces of supply and demand" and did so in response to charges made by intervenors that this term was vague, the Commission nonetheless restated (and relied again) on this very term in the explanatory discussion accompanying its rule. Cinergy submits that these clarifications giving meaning to the term manipulative conduct under Market Behavior Rule 2 can only gain clarity (and thus pass Constitutional muster) as the market and future case law develop.

12. Intervenors conclude that, at present, Market Behavior Rule 2 and its subparts cannot be applied retroactively under any circumstances and therefore can only be applied, consistent with the requirements of fair notice and due process, on a prospective basis, i.e., after the Commission has articulated the applicability of its sanction relative to the facts of a particular case.[11] Intervenors also challenge our other Market Behavior Rules as well as our procedural guidelines on the grounds that they too are vague and overbroad.

2. Commission Finding

13. The Commission's Market Behavior Rules, including the prohibitions relating to market manipulation, are not unduly vague.[12] Constitutional due process requirements mandate that the Commission's rules and regulations be sufficiently specific to give regulated parties adequate notice of the conduct they require or prohibit.[13] This standard is satisfied "[i]f, by reviewing [our rules] and other public statements issued by the

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[11] Cinergy restates this same argument as a challenge to the Commission's section 205 authority. See Cinergy request for rehearing at 8-9 ("Under section 205, the Commission may place conditions in a tariff, but . . . those conditions must be specific and the required actions must be capable of definition on the date they become effective.").

[12] In this regard, we note that the due process challenges raised on rehearing are limited to challenges to the Commission's rules on their face, i.e., to assertions that the Commission's rules are vague in all possible applications. There are no due process rehearing claims challenging the application of the Commission's rules to a particular case.

[13] See Freeman United Coal Mining Company v. Federal Mine Safety and Health Review Commission, 108 F.3d 358, 362 ((D.C. Cir. 1997) (Freeman).

agency, a regulated party acting in good faith would be able to identify, with ascertainable certainty, the standards with which the agency expects parties to conform."[14] The Commission's Market Behavior Rules satisfy this due process requirement. Our rules are "sufficiently specific that a reasonably prudent person, familiar with the conditions the regulations are meant to address and the objectives the regulations are meant to achieve, would have fair warning of what the regulations require."[15]

14. This due process standard, moreover, allows for flexibility in the wording of an agency's rules and for a reasonable breadth in their construction.[16] The courts have recognized, in this regard, that regulations cannot list all of the infinite variety of situations to which they may apply and that "[b]y requiring regulations to be too specific, [courts] would be opening up large loopholes allowing conduct which should be regulated to escape regulation."[17] The Supreme Court has further noted that the degree of vagueness tolerated by the Constitution, as well as the relative importance of fair notice and fair enforcement, depend in part on the nature of the rules at issue. For example, in the case of economic regulation (as opposed to criminal sanctions), the vagueness test is applied in a less strict manner because, among other things, "the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process." Village of Hoffman Estates, et al. v. The Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1981).[18]

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[14] See General Electric Co. v. EPA, 53 F.3d 1324, 1329-30 (D.C. Cir. 1995) (holding that the agency's interpretation of its rules was "so far from a reasonable person's understanding of the regulations that [the regulations] could not have fairly informed GE of the agency's perspective.").

[15] See Freeman, 108 F.3d at 362. See also Faultless Division, Bliss & Laughlin Industries, Inc. v. Secretary of Labor, 674 F.2d 1177, 1185 (7th Cir. 1982) ("[T]he regulations will pass constitutional muster even though they are not drafted with the utmost precision; all that due process requires is a fair and reasonable warning.").

[16] See Grayned v. City of Rockford, 408 U.S. 104, 110 (1971) (holding that an anti-noise ordinance was not unconstitutionally vague where the words of the ordinance "are marked by flexibility and reasonable breadth, rather than meticulous specificity.").

[17] Ray Evers Welding Co. v. OSHRC, 625 F.2d 726, 730 (6th Cir. 1980).

[18] See also Texas Eastern Products Pipeline Co. v. OSHRC, 827 F.2d 46, 50 (7th Cir. 1987) ("Texas Eastern, as a major pipeline company, in which trenching and

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15. Applying these standards, we reiterate, here, as we found in the Market Behavior Rule Order, that our Market Behavior Rules satisfy the requirements of due process. Our rules provide sufficient notice of the conduct prohibited. Under Market Behavior Rule 2, for example, sellers are put on notice that actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products will be prohibited

16. The Commission has carefully considered the terms and requirements of its Market Behavior Rules and the comments it received in light of its obligation to assure that market-based rate sales are just and reasonable and the requirement that sellers have reasonable notice of the obligations and prohibitions to which they are subject as participants in a competitive market subject to Commission oversight. We find these rules necessary to assure that rates in the markets at issue will be just and reasonable, and that the rules are consistent with the constitutional requirements of due process.

B. Market Behavior Rule 1 (Unit Operation)

> *Seller will operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the Commission-approved rules and regulations of the applicable power market. Compliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller.*[19]

1. Requests for Rehearing and Clarification

17. Rehearing applicants challenge our determination that Market Behavior Rule 1 will not be allowed to serve as an independent basis to impose any new obligations on sellers or to further regulate the bilateral market.[20] The American Public Power

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excavation are a part of its routine, had ample opportunity to know of the earlier interpretation, should have been able to see the sense of the regulations on their face, and if still in doubt Texas Eastern should have taken the safer position both for its employees and for itself.").

[19] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 18-23.

[20] Id. at P 21.

Association and the Transmission Access Policy Study Group (APPA and TAPS) request clarification that this ruling will be limited in its application to Market Behavior Rule 1 and thus is not intended to shield bilateral market participants from liability for failing to follow any other market rules to which they may be subject. The National Association of State Utility Consumer Advocates (NASUCA) alleges as error the Commission's determination to not apply Market Behavior Rule 1 to bilateral transactions.

18. Consumer Advocates,[21] the California Electricity Oversight Board (Cal Oversight Board), and the California Public Utilities Commission (California Commission) allege as error the Commission's failure to include an affirmative real-time must-offer obligation as a basic requirement applicable to sellers' market-based rate authorizations. The Cal Oversight Board argues that such a requirement is necessary because a seller who may make no false statement regarding the operational capabilities of its units (and who thus could not be sanctioned to this extent), could nonetheless withhold its capacity from the market for manipulative purposes by simply refusing to tender a bid.

19. The California Commission argues that a must-offer requirement is a fundamental condition for a workably competitive market and that without such a requirement, physical withholding and other market power abuses may go unchecked. Consumer Advocates add that if a load serving entity (LSE) is relying on a particular seller to meet the LSE's required capacity reserve margin, the seller should have an obligation to make its power available to the LSE so long as the seller's plant is physically able to operate.

20. Consumer Advocates and the California Commission request clarification that Market Behavior Rule 1 prohibits both physical and economic withholding as those terms are defined by the Commission in the Market Behavior Rules Order, even in those markets that do not have their own Commission-approved prohibition.[22]

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[21] The Consumer Advocates are comprised of the following entities: the Colorado Office of Consumer Counsel; the Attorney General of the State of New Mexico; the Utah Committee of Consumer Services; the Public Utility Law Project of New York, Inc.; the National Consumer Law Center, Inc.; and Public Citizen, Inc.

[22] In the Market Behavior Rules Order, we found that to the degree physical withholding or economic withholding issues are the subject of an applicable power market's rules and regulations, seller's compliance with such rules and regulations will satisfy seller's compliance with Market Behavior Rule 1. We also found that to the degree physical withholding and economic withholding could be components of activities that might be found to constitute market manipulation in a given case under Market Behavior Rule 2. Id. at P 102. We noted that the term physical withholding means not

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21. Other intervenors seek to narrow the application of the Commission's rule. Cinergy requests clarification that the Commission's rule will only apply to organized spot markets run by RTOs and not to any other transaction into, out of, or through an RTO. Merrill Lynch and Morgan Stanley allege as error the Commission's determination that Market Behavior Rule 1 will apply to power marketers in addition to entities that own or control generation. Merrill Lynch and Morgan Stanley argue that the Commission's rule cannot and should not apply to power marketers who do not own or control generation.

2. Commission Ruling

22. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 1. The core requirement embodied in our rule -- that sellers conduct their business in a manner that complies with the Commission-approved rules and regulations of the applicable power market -- does not impose a substantive obligation on sellers independent of any other Commission-approved rule or regulation. As such, Market Behavior Rule 1 neither expands upon nor limits any right or obligation which may currently apply to sellers, or which may be found to apply in the future pursuant to a filing made under section 205, or a proceeding instituted under section 206. Instead, Market Behavior Rule 1 is intended to serve the purpose of reinforcing a seller's compliance obligation to adhere to Commission-approved rules and provides a remedy, with specified complaint procedures in those cases where a seller has failed to follow a Commission-approved rule or regulation.

23. The requests for rehearing, by contrast, seek to either expand the reach of Market Behavior Rule 1, in some cases, or narrow its application in other cases, by adding substantive content to the rule in the form of either new requirements (e.g., the imposition of a generic must–offer obligation) or exemptions from existing Commission-approved rules or regulations (e.g., the applicability of existing rules or regulations to power marketers). The rehearing applicants assert that under Market Behavior Rule 1, these

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offering available supply in order to raise the market clearing price (a strategy that would only be profitable for a firm that benefits from the higher price in the market). We also defined the term economic withholding to mean bidding available supply at a sufficiently high price in excess of the supplier's marginal costs and opportunity costs so that it is not called on to run and where, as a result, the market clearing price is raised (a strategy, again, that would only be profitable for a firm that benefits from the higher price in the market). Id. at notes 56 and 57.

requirements and/or exemptions should be applied to all sellers on a generic basis across all markets, notwithstanding any market-specific variations or rules which we have found to be appropriate in a given market. We decline to follow this approach here.

24. Market Behavior Rule 1 has been carefully crafted to underscore a market-based rate seller's obligation to follow Commission-approved rules and to serve as a remedial tool. As such, it cannot conflict with or defeat the objectives of existing Commission-approved rules or regulations in a specific market to which it requires compliance. While the Commission's policy objectives in recent years have included the approval of standardized rules and procedures in these markets, where appropriate, implementation of these rules and procedures has appropriately occurred, in large part, on a case-by-case basis. In doing so, moreover, we have recognized the validity of regional variations with respect to certain rules and practices. Accordingly, we will not consider here on a generic basis new rights and obligations applicable to sellers across all markets with respect to the operation of their units.

25. However, we will grant the clarification sought by APPA and TAPS concerning the interaction of Market Behavior Rule 1 with our other Market Behavior Rules. Specifically, a seller's actions which do not violate Market Behavior Rule 1 (because they do violate any Commission-approved rule or regulation in the applicable power market) could nonetheless be found to violate another Market Behavior Rule. For example, a seller's actions which standing alone do not violate Market Behavior Rule 1, could, when considered in context, be determined to constitute market manipulation under the circumstances prescribed by Market Behavior Rule 2.

26. We also reiterate that Market Behavior Rule 1 may apply to bilateral transactions where the actions undertaken by a contracting party are subject to the Commission-approved tariff, rules and regulations that apply to the applicable power market. For example, where a seller under a bilateral agreement is required to schedule a service with the transmission provider in the applicable market, the seller must do so consistent with the Commission-approved rules and regulations relating to this action.

27. Since as noted above, Market Behavior Rule 1 does not impose a new stand-alone requirement on sellers, we will reject the requests for rehearing seeking to add to our rule a substantive, must-offer requirement. As we stated in the Market Behavior Rules Order, unless the seller is subject to a must-offer requirement pursuant to the applicability of a Commission-approved tariff or other specific Commission-approved obligation, the seller will not be subject to such a requirement under our rule. We also reject the implicit rationale underlying this request, i.e., that capacity withholding for an anti-competitive purpose can only be remedied by way of a generic must-offer obligation. In fact, where a

seller intentionally withholds capacity for the purpose of manipulating market prices, market conditions, or markets rules for electric energy or electricity products, it has done so without a legitimate business purpose in violation of Market Behavior Rule 2.

28. We will also deny Cinergy's request that Market Behavior Rule 1 not be applied to certain Commission-approved rules and regulations in the applicable market, namely to transactions into, out of, or through an RTO. Market Behavior Rule 1 is intended to be industry-wide in its reach to the extent it implicates a Commission-approved rule or regulation. Cinergy offers no reason for limiting the scope of our rule and we decline to do so.

29. Finally, we will deny the request for rehearing submitted by Merrill Lynch and Morgan Stanley concerning the applicability of Market Behavior Rule 1 to power marketers who do not own or control generation. If the acts or transactions engaged in by a power marketer are subject to a Commission-approved rule or regulation in the applicable market, a power marketers' conduct in these markets will also be subject to the requirements of Market Behavior Rule 1.

C. Market Behavior Rule 2 (Market Manipulation)

Actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products are prohibited. Actions or transactions undertaken by Seller that are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) or taken at the direction of an ISO or RTO are not in violation of this Market Behavior Rule.

1. Requests for Rehearing and Clarification

30. Cinergy, Duke, Puget Sound, et al., Merrill Lynch and Morgan Stanley, and Mirant and Williams challenge Market Behavior Rule 2 on the grounds that the rule, as adopted, is unconstitutionally vague and overbroad and that, as such, its prohibitions will be both unlimited and unknowable.[23] Conversely, Consumer Advocates charge that these same alleged ambiguities will lead to a too-narrow application of the Commission's rule to the extent that sellers can rely on these alleged ambiguities to create loop holes or

[23] These rehearing requests were addressed, in part, in Section A, above, in which we discussed the applicable case law and other legal issues relating to the rehearing applicants' due process challenges.

otherwise shield their conduct as "legitimate." Each of these rehearing applicants finds fault in the Commission's definition of market manipulation and the term "legitimate business practice," absent a more specific enumeration of the acts or transaction to which these standards will be applied.

31. The Edison Electric Institute (EEI) and the Electric Power Supply Association (EPSA), by contrast, seek only minor clarifications to these standards. Specifically, EEI and EPSA request clarification that the foreseeability test set forth in the rule will be applied by the Commission in a given case based on whether a reasonable person would have foreseen the manipulative conduct at issue.[24] Sempra Energy (Sempra), on the other hand, suggests that the clause "or forseeability could" is unnecessary to the extent that it restates the subjective intent standard already embodied in Market Behavior Rule 2. Sempra also requests clarification that, in contrast to this subjective intent standard, the lack of a legitimate business purpose is an objective element based on the nature of the conduct and does not refer to a seller's state of mind, i.e., to intent or knowledge of the seller. Sempra also requests clarification that both the intent requirement (a subjective test) and the lack of a legitimate business purpose (an objective test) must be demonstrated to support a violation under Market Behavior Rule 2.

32. EEI seeks clarification that where a seller is found to have complied with the Commission-approved rules of an RTO or ISO in a manner that was reasonable at the time, such a seller cannot be found to have violated Market Behavior Rule 2.

33. Merrill Lynch, Morgan Stanley, Mirant and Williams renew their request that Market Behavior Rule 2 include an express intent standard that does not rely on a foreseeability component. Specifically, Merrill Lynch and Morgan Stanley submit that a seller should not be found liable under Market Behavior Rule 2 absent a finding that (i) the seller had the ability to manipulate the market when it engaged in the behavior in question; (ii) the seller intended to manipulate the market when it engaged in the behavior in question; and (iii) the behavior in question caused the market manipulation.

34. NASUCA, on the other hand, argues that in adopting what it characterizes as a dual intent standard (requiring first a determination of whether the seller has a legitimate business purpose for its actions and then, second, whether the action is intended to manipulate markets), the Commission unfairly imposes on complainants and itself an undue burden, given the fact that neither a would-be complainant nor the Commission

[24] By contrast, Merrill Lynch and Morgan Stanley assert that the reasonable person approach will, in all probability, increase the inefficiency of the complaint process and create regulatory uncertainty.

will have access to the data or information necessary to prove such claims. NASUCA requests that the Commission delete its intent requirement from Market Behavior Rule 2 or, in the alternative, clarify that intent to manipulate is not an element of a prima facie case and that the burden to show that the actions were not intended to manipulate the market remain on the sellers. Similarly, the Transmission Dependent Utility Systems (TDU Systems) asserts that the Commission erred in including intent as an element of market manipulation.

35. Duke seeks clarification that in defining prohibited activity under Market Behavior Rule 2, the Commission will not equate bids made above marginal cost in competitive wholesale markets as manipulative or lacking a legitimate business purpose. Duke urges the Commission not to equate competitive outcomes with marginal cost.

36. Finally, the California Commission takes issue with the Commission's stated requirements regarding requested contract revisions by one party to a contract predicated on the allegation that the other party has violated the Commission's Market Behavior Rules.[25] The California Commission argues that a requirement that the complainant in such a case demonstrate that the violation had a direct nexus to contract formation and tainted contract formation itself is not explained by the Commission and is otherwise unjustified.

2. Commission Ruling

37. We will deny rehearing of the Market Behavior Rules Order as it relates to our market manipulation standard under Market Behavior Rule 2. First, for the reasons discussed in Section A, above, our market manipulation standard does not violate the due process requirement embodied in the U.S. Constitution. In fact, this due process requirement is satisfied here by a prohibition which puts sellers on clear notice that their actions and transactions must have a "legitimate business purpose," i.e., an intended or desired result that is consistent with the seller's authorized business activities. Because this purpose relates to the seller's own motives and business objectives, moreover, this purpose will in every case be known to the seller, by definition, even before the act or transaction is undertaken.

38. Moreover, the legitimacy of this conduct, as the Commission might view it in a given case, will also be known or knowable to the seller in the vast majority of cases. This is so because the seller's conduct, in most cases, will track or be related to established industry practices, as previously authorized or permitted by the Commission.

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[25] Market Behavior Rules Order, 105 FERC ¶ 61,218 at P 45.

While in other possible cases, the seller may have some uncertainty regarding the Commission's assessment of the legitimacy of its conduct (to the extent this conduct may be novel or otherwise untested) the seller in this instance will be free to defend its conduct before the Commission in any proceeding in which this conduct may be at issue. Due process under the law requires no more and would not prohibit the Commission from interpreting (and applying) its rules to the facts and circumstances presented in a case of first impression.

39. In addition, any uncertainty regarding the meaning or application of our rule has already been minimized in large part by a prohibition that has been carefully crafted in its scope. By its terms, our rule addresses only actions or transactions that can have no legitimate business purpose and which are intended to or foreseeably could manipulate market prices, market conditions, or market rules. Market Behavior Rule 2 is further narrowed in its reach to exclude acts explicitly contemplated by Commission-approved rules and regulations in the applicable power market or acts taken at the direction of an ISO or RTO.

40. We will also deny the requests for rehearing seeking greater specificity in the meaning of the term "legitimate business purpose." Consumer Advocates assert that specificity is necessary in order to prevent sellers from fabricating any number of "legitimate business purposes" as a defense to their otherwise manipulative conduct. On the other hand, others assert that this specificity is required in order to limit sellers' potential liability to specifically enumerated acts or transactions. These rehearing applicants therefore request additional clarifications regarding the possible application of our standard to specific conduct.

41. However, we decline to consider here the various hypothetical applications of our standard in a given case, beyond the specific prohibitions addressed in the four subparts to Market Behavior Rule 2. While clarifications of this sort would arguably give our rule greater definition, as to that conduct to which these clarifications might squarely apply, they might also invite the creation of loopholes which could be used by sellers for the purpose of avoiding our rule. As such, this specificity could have the unintended effect of excluding from our prohibition conduct which should be prohibited. Our rule, instead, has been designed to remain flexible in a way that will both comport with the requirements of due process and serve to prohibit all forms of market manipulation, including market abuses whose precise form and nature cannot be envisioned today.

42. Several parties have argued that intent or foreseeability[26] should not be part of the definition for market manipulation or otherwise request that the definition be modified.[27] We decline to do so. In the Market Behavior Rules Order, we stated that in determining whether an activity has violated our rules, we would examine all relevant facts and circumstances surrounding the activity to establish its purpose and intended or foreseeable result. If that intended or foreseeable result is the manipulation of market prices, market conditions or markets rules, then the seller will be found to have violated the rule against market manipulation. With the exception of subpart 2(a) Wash Trades, which is a per se violation, all of the subparts of Market Rule 2 are subject to this standard.

43. In considering the foregoing, we will look to determine whether the action or transaction was undertaken with a legitimate business purpose. For example, we explained in the Market Behavior Rules Order that if the behavior was undertaken to provide service to a buyer with rates, terms and conditions disciplined by the competitive forces of the market, we would find the transaction to have a legitimate business purpose. Since the underlying purpose of an action is not always obvious and conclusions regarding the intent of others are often a matter of judgment, we found that we would base our enforcement of this rule on a careful consideration of the facts and circumstances of the conduct at issue, recognizing that intent must often be inferred therefrom.

44. In developing this standard, we recognized that actions without a legitimate business purpose which would foreseeably result in a distorted price not reflective of a competitive market are appropriately attributed to the seller as manipulative acts. Accordingly, our standard looks to place such conduct in context; it considers the facts to discern the purpose of the conduct; and takes action when the seller's action was intended to or foreseeably would manipulate the market. All of the foregoing elements are related and the Commission will consider them all in considering potential violations of this rule.

45. Finally, we will deny rehearing regarding our clarifications in the Market Behavior Rules Order concerning requests made by a contracting party to modify its contract based on the allegation that the other party to the contract has violated our Market Behavior Rules. In the Market Behavior Rules Order, we held that our Market Behavior Rules

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[26] Of course, the concept of foreseeability includes the concept of reasonableness. As defined by Webster's Third New International Dictionary, "foreseeable" means: "being such as may be reasonably anticipated."

[27] See, e.g., NASUCA, Merrill Lynch and Morgan Stanley, EEI, and EPSA.

could not be used as a vehicle, in this context, to support or justify the abrogation of a contract, unless the rule violation at issue has a direct nexus to contract formation and thus tainted the contract itself. In fact, this clarification was nothing more than a restatement of a principle applicable to the interpretation and enforcement of contracts and the Commission's own policies with respect to contract abrogation.[28]

D. Market Behavior Rule 2(a) (Prohibition Against Wash Trades)

> *Prohibited actions and transactions include, but are not limited to: (a) pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk and no net change in beneficial ownership (sometimes called "wash trades").*

1. Requests for Rehearing and Clarification

46. The Cal Oversight Board and NASUCA argue that the Commission's definition of a "wash trade," in subpart (a) of Market Behavior Rule 2, is unnecessarily narrow in its reach by including within its sanction transactions involving the same parties, the same quantity and no economic risk. The Cal Oversight Board asserts that a seller can too easily evade the Commission's rule by only slightly altering a price or quantity term in a transaction that may in substance and intent be a wash trade, or by making an arrangement with an independent or affiliated third party. NASUCA adds that the Commission should reconsider its definition of wash trade to include transactions of de minimis value.

47. Puget Sound, et al. and Sempra Energy request clarification that energy exchanges at different locations entered into by sellers to avoid the need for transmission service and performed on terms that do not involve different prices or a net transfer of beneficial ownership will not be regarded as a prohibited wash trade. In addition, Merrill Lynch and Morgan Stanley assert as error the Commission's determination that a wash trade can involve more than one location. Merrill Lynch and Morgan Stanley note that, in fact, under the Commodity Exchange Act, the prohibition against wash trades in the futures

[28] In addition, we note that these rules will not supersede or replace parties' rights under section 206 of the FPA to file a complaint contending that a contract should be revised by the Commission, pursuant to either the "just and reasonable" or "public interest" tests as required by the contract.

market is limited to the same delivery point. In addition, Merrill Lynch and Morgan Stanley request that subpart (a) of Market Behavior Rule 2 be revised to expressly address the temporal element of a wash trade, i.e., that a wash trade be defined as simultaneous or nearly so (within seconds of each other).

48. Finally, EPSA argues that in order to insure clarity, the Commission should conform its tariff prohibition against wash trades with the corresponding legislative prohibition against "round trip trading" currently pending before Congress.[29]

2. Commission Ruling

49. We will deny rehearing regarding our adoption of a specific prohibition against wash trades. As we noted in the Market Behavior Rules Order, a seller who engages in a wash trade does so for the purpose of sending an inaccurate price signal to the marketplace and then benefiting, or attempting to benefit (or having the capacity to benefit), from the trading opportunities that may arise as a result. Specifically, a seller engaging in a wash trade may have the ability to manipulate market prices by creating the illusion of trading activity (i.e., market liquidity) in a given market and/or the illusion of price movement. The seller may then attempt to "cash in" in the form of a third party transaction when the price is right. Under Market Behavior Rule 2(a), however, the triggering event in this chain of manipulation, i.e., the wash trade, is expressly prohibited when it involves a pre-arranged offsetting trade of the same product among the same parties and involves no economic risk and no net change in beneficial ownership.

50. NASUCA disagrees with the Commission's definition of wash trades. NASUCA argues that trades that involve de minimis value should be included in the definition of wash trades because such trades could be used to circumvent the rule and manipulate

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[29] EPSA cites the following proposed language:

> SEC. 220(b) For the purposes of this section, the term "round-trip trade" means a transaction, or combination of transactions, in which a person or other entity (1) enters into a contract or other arrangement to purchase from, or sell to, any other person or other entity electric energy at wholesale; (2) simultaneously with entering the contract described in paragraph (1), arranges a financially offsetting trade with such other person or entity for the same quantity of electric energy so that, collectively, the purchase and sale transactions in themselves result in no financial gain or loss; and (c) has the specific intent to distort reporting revenues, trading volumes, or prices.

market prices just as easily as wash trades of no value. Merrill Lynch and Morgan Stanley argue that the Commission should clarify the parameters of a prohibited wash trade by limiting the designation to trades that occur at the same delivery point and requiring prohibited wash trades to be "simultaneous," or within seconds of each other.[30]

51. The Commission declines to modify its definition of wash trades based upon these comments. Under our prohibition, it must be shown that the seller has purposefully created a prearranged off-setting trade with no economic risk, and no net change of beneficial ownership. Such actions have no legitimate business purpose and such behavior, standing alone, constitutes a per se violation of Market Behavior Rule 2(a). While NASUCA has made what appears to be, at first impression, a request for a minor modification to the Commission's definition of wash trades, to grant the requested modification would materially alter and detract from the clarity of our rule. To include trades of de minimis value in our definition of the term wash trade, under our rule, the Commission would be required to include trades that are not offsetting, that have a level of economic value and that result in a net change of beneficial ownership (however small). In addition, the Commission would be required to further define its views regarding what amount of value constituted a de minimis amount given the circumstances of the trade.

52. Further, in the Commission's view there is no need to modify this definition to include trades that involve de minimis values. While it is conceivable that a series of trades for de minimis amounts may be shown through evidence to constitute a scheme to manipulate the market, such action, while not a violation of the Commission's prohibition, would constitute a violation of the Commission's market manipulation standard under Market Behavior Rule 2.

53. The Commission also declines to limit its definition of wash trades to simultaneous trades that occur at the same delivery point. The Commission's definition provides that a wash trade is a pre-arranged offsetting trade of the same product among the same parties, which involves no economic risk, and no net change in beneficial ownership. We have also recognized that such a transaction constitutes a per se violation of Market Behavior Rule 2(a). Pursuant to the Commission's definition, a wash trade must be pre-arranged but the offsetting portion of the trade may be executed at a separate time and/or delivery point. The Commission declines to adopt the suggested modification because this would permit parties to engage in activity that is currently prohibited by merely agreeing to execute the offsetting portion of the trade at a different place or time.

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[30] See Merrill Lynch and Morgan Stanley's Request for Rehearing at 13.

54. Puget Sound, et al. and Sempra Energy submit that if an exchange involving neither a change in price nor a transfer in beneficial ownership is entered into by a seller to avoid the need for transmission service, the exchange should not be regarded as a prohibited wash trade. We disagree with the intervenors' characterization of an exchange. In the Market Behavior Rules Order, we addressed a similar request for clarification made by EEI and found that because an exchange would either be at different prices, transfer beneficial ownership, or both, an exchange could not be characterized as a wash trade as we define it.

55. We will also deny the request sought by Merrill Lynch and Morgan Stanley that we limit our prohibition to wash trades occurring simultaneously or within seconds of each other. While most wash trades may, in fact, occur under these circumstances, this temporal element would ultimately be an irrelevant consideration as it relates to the market abuse we are attempting to prevent, where a pre-arranged offsetting trade otherwise qualifies as a wash trade under our rule. In fact, our rule will prohibit any such transaction regardless of the timing sequence that may be utilized by the seller.

56. Finally, we decline to adopt at this time the proposed language currently pending before Congress which would, if adopted and signed into law, provide a statutory prohibition against wash trades. Our rule, which has been established pursuant to a regulatory process authorized under the FPA, stands on its own, based on a merits determination fully set forth in the Market Behavior Rules Order and reviewed here on rehearing.

E. Market Behavior Rule 2(b) (Prohibition Against Transactions Predicated on Submission of False Information)

Prohibited actions and transactions include, but are not limited to:
(b) transactions predicated on submitting false information to transmission providers or other entities responsible for operation of the transmission grid (such as inaccurate load or generation data; or scheduling non-firm service for products sold as firm), unless Seller exercised due diligence to prevent such occurrences.

1. Requests for Rehearing and Clarification

57. Intervenors seek rehearing and clarification regarding the Commission's due diligence provisions as embodied in Market Behavior Rules 2(b), 2(c), and 3. The California Commission argues that a seller's implementation of these due diligence procedures should not operate as a defense for sellers regarding their employees'

potential misconduct and that, in such a case, the state of mind of the seller's employees may be considered in adjudicating the seller's liability.

58. Sierra Southwest Cooperative Services, Inc. (Sierra Southwest) seeks clarification regarding the interplay between the intent standard embodied in the preamble requirement of Market Behavior Rule 2 and the due diligence standard set forth in subparts (b) and (c). Specifically, Sierra Southwest submits that predicating a seller's liability on its failure to exercise due diligence is the functional equivalent of a strict liability standard that cannot be reconciled with the intent requirement set forth in the Commission's preamble requirement.

59. Sempra requests clarification that the adoption of the procedures required by these due diligence provisions is intended to operate as a safe harbor for sellers in the form of a rebuttable presumption that the seller did not engage in conduct prohibited by Market Behavior Rules 2(b), 2(c), and 3. TDU Systems submits that the seller should be given the burden of proof to demonstrate that it had an adequate due diligence mechanism in place.

60. Cinergy and TDU Systems request clarification regarding the guidelines that will define for the industry the actions a seller needs to take to be in compliance with the Commission's due diligence standard. In addition, Cinergy requests clarification that a violation of the Commission's Market Behavior Rules by an employee of a seller will not constitute a prima facie case supporting a finding that the seller has failed to exercise due diligence. Cinergy asserts that absent these clarifications, the Commission's due diligence standard is unduly vague and unlawful.

61. Merrill Lynch and Morgan Stanley, as well as EEI, urge the Commission to utilize an intent standard in Market Behavior Rule 2(b). EEI asserts that this intent standard could be used in conjunction with the Commission's due diligence standard and asks the Commission to establish a workshop on an expedited basis to develop due diligence principles that could function as a safe harbor for sellers. EEI also notes that in evaluating due diligence immediately following the effective date of the Market Behavior Rules, a safe harbor transition allowance should be considered by the Commission.

62. EEI also seeks clarification that if a party provides information to a counterparty and then the counterparty alters the information, intentionally or inadvertently, the first party is not in violation of Market Behavior Rule 2(b). EEI also seeks clarification regarding the Commission's illustrative examples of prohibited transactions predicated on false information. EEI seeks clarification that use of non-firm transmission for a financially firm product where the seller of the financially firm product has agreed to make the buyer whole, if the transmission is cut, would not be a prohibited transaction predicated on false information.

63. Finally, Powerex Corp. (Powerex) requests clarification that Market Behavior Rule 2(b) contains a typographical error (with substantive implications) regarding the scheduling of non-firm service for products sold as firm. Specifically, Powerex asserts that the parenthetical clause "scheduling non-firm service or products as firm" should instead read "scheduling non-firm service for products as firm."

2. Commission Ruling

64. We will deny rehearing of the Market Behavior Rules Order relating to our adoption of Market Behavior Rule 2(b). However, we will also provide certain clarifications of our rule as it relates to the interplay between our intent requirement addressed in our market manipulation standard under Market Behavior Rule 2 and our due diligence allowance as set forth in the specific context of subpart (b) of our rule.[31]

65. Market Behavior Rule 2(b) prohibits transactions predicated on submitting false information to a transmission provider or other entities responsible for the operation of the transmission grid in the applicable market. In the Market Behavior Rules Order, we noted that the conduct addressed by this prohibition represented a specific form of market manipulation which cannot have a legitimate business purpose. We also acknowledged, however, that inadvertent or honest errors would be excused from our prohibition because the submission of false information under these circumstances would not meet the intent requirement as set forth in the main body of our rule, i.e., the seller, in this instance, would not have "intended to or foreseeably could [have] manipulate[d] market prices, market conditions, or market rules for electric energy or electricity products."

66. Unlike the occurrence of a wash trade, then, the submittal of false information to a transmission provider or other entities responsible for the operation of the transmission grid in the applicable market is not a per se violation of our Market Behavior Rules. Specifically, a violation of Market Behavior Rule 2(b) cannot be based on the nature of conduct itself if a finding can be made that the submission at issue is attributable to an inadvertent or honest error.

67. We also addressed how this element of intent would be measured. We stated that we would not find a seller in violation of our rule in those cases where the seller can demonstrate that it has exercised due diligence to prevent the occurrence of the conduct at issue. We also stated, however, that we would examine the seller's conduct in relation to

[31] We will address separately, below, our due diligence standard as it relates to Market Behavior Rules 2(c) and 3.

the procedures instituted by the seller to assure the sufficiency and accuracy of the submitted information. We stated that we would not treat as a defense to our rule, evidence that a given individual under the seller's direction or control did not personally know that the information it had submitted on the seller's behalf was false or incomplete. Conversely, where the seller can demonstrate that it has implemented procedures reasonably designed to comply with our rules, we will treat that evidence as a rebuttable presumption that the seller did not engage in the conduct prohibited by Market Behavior Rules 2(b), 2(c), and 3. Thus, we will grant Sempra's request for clarification relating to this issue.

68. The California Commission seeks rehearing regarding this due diligence standard, asserting that the procedures implemented by the seller should not operate as a defense to our rule. We will deny rehearing. The due diligence allowance adopted in our rule is an appropriate defense accorded to sellers accused of a violation of Market Behavior Rule 2(b), because the evidence it would bring before the Commission may be directly relevant to the issue of intent (an element of any subpart (b) violation). Specifically, where there are procedures in place to assure the sufficiency and accuracy of the information submitted by the seller to a transmission provider or other entities responsible for the operation of the transmission grid in the applicable market, it may be found in a given case that the false submission at issue was in the nature of an inadvertent or honest error.[32]

69. However, we will grant the California Commission's request for clarification that the state of mind of the seller's employees may be permitted to be considered in adjudicating the seller's liability under Market Behavior Rule 2(b). While as a prima facie matter, the conduct of the seller alone may be relied upon by complainants, or the Commission, without reference to the state of mind of seller's employees or any other evidence, our due diligence standard is not intended to bar the consideration of evidence supporting the conclusion that the individual trader personally knew that the information at issue was false.[33]

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[32] Thus, we will reject Sierra Southwest's suggestion that a finding made by the Commission that a seller has failed to exercise due diligence would impose a strict liability requirement that is inconsistent with our intent requirement under Market Behavior Rule 2. In fact, these requirements as they relate to Market Behavior Rule 2(b) are one and the same. Specifically, the absence of due diligence would support an inference of intent on the seller's part based on the facts and evidence presented.

[33] As such, we reject Cinergy's request for clarification that a violation of subpart (b) by an employee of a seller will not constitute a prima facie case supporting a

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70. Moreover, we will consider the defense of due diligence on a case-by-case basis utilizing the complaint procedures outlined by the Commission in the Market Behavior Rules Order. As such, we will deny those requests for rehearing seeking to establish additional a priori rules and guidelines involving rebuttable presumptions and burden and proof determinations. We also decline to prejudge or otherwise commit the Commission to any advance determinations regarding the existence or absence of due diligence in a given case.

71. We will also deny the clarification sought by EEI concerning the altering of information provided by a seller to a counterparty. If a seller provides information to a counterparty and then the counterparty alters the information, intentionally or inadvertently, the seller can only be held liable under our rule if the seller then submits this inaccurate information to the transmission provider or other entities responsible for operation of the transmission grid without exercising the requisite due diligence to confirm its accuracy.

72. However, we will grant EEI's requested clarification regarding the use of non-firm transmission for a financially firm product under certain conditions agreed to by the parties in their bilateral contract. We agree that where the parties' contract permits this scheduling allowance, such a practice would fall within the Commission-approved rules and regulations of an applicable power market and thus not be in violation of our rule.

73. Finally, we will grant the request made by Powerex and thus hereby clarify that the parenthetical clause "scheduling non-firm service or products as firm," as it appears in Market Behavior Rule 2(b), should read: "scheduling non-firm service for products as firm" (emphasis added).

F. Market Behavior Rule 2(c) (Prohibition Against Transactions Relating to the Creation of Artificial Congestion Followed by the "Relief" of Such Artificial Congestion)

Prohibited actions and transactions include, but are not limited to:
(c) transactions in which an entity first creates artificial congestion and then purports to relieve such artificial congestion (unless Seller exercised due diligence to prevent such occurrence).

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violation of our rule. In fact, this evidence may be the only evidence available to a complainant at the time it is required to file its complaint.

1. Requests for Rehearing and Clarification

74. Consumer Advocates assert as error the authorized scope of Market Behavior Rule 2(c), pointing out that market power can be exercised by sellers during all periods of congestion, regardless of whether this congestion is or is not caused by artificial means. Consumer Advocates note that Market Behavior Rule 2(c) fails to specify how a seller's market power will be constrained during all such periods of constraint. Consumer Advocates submit that the Commission's rule be reframed and broadened to address all levels of transmission congestion however it may be caused.

75. EEI and Puget Sound, et al. request clarification regarding the Commission's definition of artificial congestion as including "all forms of congestion that may result from scheduling power flows in an uneconomic manner for the purpose of creating congestion (real or perceived)."[34] EEI requests clarification that any activity found to have a "legitimate business purpose," as that term is used in Market Behavior Rule 2, cannot be found to be "uneconomic" as that term is used the context of subpart 2(c) of this rule. Puget Sound, et al, argues that neither the term "artificial congestion" nor the term "scheduling power flows in an uneconomic manner" is defined with sufficient particularity.

76. In addition, Puget Sound, et al. question the workability of the Commission's due diligence standard as it applies in the case of congestion. Puget Sound, et al. assert that power flows and the creation of congestion will be affected by the activity of third party sellers and that, as such, no internal processes established by any single seller will be able to account for these occurrences. Accordingly, Puget Sound, et al. argue that Market Behavior Rule 2(c) should be revised to state explicitly that the creation of "artificial congestion" by a market participant must be intentional if it is to be prohibited.

77. Merrill Lynch and Morgan Stanley argue that to ensure that Market Behavior Rule 2(c) is not interpreted to mean that a seller is responsible for transactions in which any entity creates artificial congestion that the seller subsequently relieves, the Commission should substitute "Seller" for "an entity."

[34] See Market Behavior Rules Order, 105 FERC ¶ 61,218 at P 79.

2. Commission Ruling

78. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 2(c). First, we reject Consumer Advocates' suggestion that our rule cannot achieve its stated objective. Our rule is designed to prohibit a specific form of market manipulation that first came to our attention in connection with the so-called Enron trading strategies in the Western markets. The creation and relief of artificial congestion in these markets, we found, was a form of market abuse that in many cases was both significant and harmful.

79. At the same time, we have also acknowledged that the threat posed by this particular form of market manipulation may be a relatively limited one on a going forward basis. For example, it is unlikely to occur in an unorganized market where the transmission provider relies on Available Transmission Capacity assessments to schedule transmission. Nor should this form of market abuse occur in an organized market relying on Locational Marginal Pricing (LMP). Nonetheless, our prohibition serves as an important illustrative example of the type of market abuse our rule (Market Behavior Rule 2) is intended to prohibit, while continuing to serve a "real world" function in those organized markets that have yet to adopt an LMP system.

80. We will also reject Consumer Advocates' request that we broaden the scope of our rule to address congestion in all its forms, not just artificial congestion created by a seller whose intent is to manipulate the market. In fact, the thrust of Market Behavior Rule 2(c) is properly focused on market manipulation and purposeful conduct on the part of sellers that cannot have a legitimate business purpose. Accordingly, we will not address here, on an industry-wide basis, issues which can and already are being addressed by Commission-approved rules in individual markets.

81. However, we will grant the additional clarification requested by EEI and Puget Sound, et al. regarding our earlier clarification in the Market Behavior Rules Order that artificial congestion under our rule would be construed to include any form of congestion that may result from scheduling power flows in an uneconomic manner for the purpose of creating real or perceived congestion. As requested, we clarify that a given scheduling strategy found to have a legitimate business purpose, as that term is used in Market Behavior Rule 2, cannot be found to have been the product of "uneconomic" conduct under subpart (c) of our rule. However, we note that Market Behavior Rule 2(c) contemplates a combined act involving, first, the creation of artificial or real congestion and then, second, an effort to relieve that congestion in exchange for a payment or compensation of some sort. Absent unexpected congestion which comes about in the dynamic operation of the power grid, we would not expect to discover many, if any, legitimate business purposes associated with such activity.

82. With respect to the operation and effect of our due diligence standard, in this context, we clarify that to rebut a prima facie case in which the seller's conduct alone and the facts and circumstances of the market as a whole are relied upon to infer intent, the seller may introduce evidence that the scheduling procedures it follows are reasonably designed to prohibit such conduct or render any conduct inadvertent.

83. Finally, we will grant the clarification requested by Merrill Lynch and Morgan Stanley concerning the reference in our rule to an "entity" that first creates artificial congestion and then purports to relieve such artificial congestion. We clarify that the "entity" to which this rule refers is the seller.

G. Market Behavior Rule 2(d) (Prohibition Against Certain Collusive Acts)

Prohibited actions and transactions include, but are not limited to:
(d) collusion with another party for the purpose of manipulating market prices, market conditions, or market rules for electric energy or electricity products.

1. Requests for Rehearing and Clarification

84. Consumer Advocates and NASUCA assert that Market Behavior Rule 2(d), which only prohibits overt collusion among parties for the purpose of manipulating market prices, fails to address market behaviors other than overt collusion which may also raise market prices above competitive levels. Consumer Advocates note that multilateral strategic bidding is one such example that may drive costs well above a competitive level. NASUCA adds that unintentional acts that are nonetheless within the control of the seller should also be prohibited under Market Behavior Rule 2(d).

85. Puget Sound, et al. argues that Market Behavior Rule 2(d) appears to add no prohibition that would not also be covered (and covered adequately) by the preamble requirement of Market Behavior Rule 2, i.e., that the preamble requirement would appear to cover proscribed activity involving one or more sellers. Puget Sound, et al. submit that if subpart (d) covers acts or transactions not covered by the preamble requirement, the Commission should specifically enumerate these prohibitions on rehearing.

86. Merrill Lynch and Morgan Stanley allege as error the Commission's failure to clarify the behavioral elements that may indicate collusion under either the FPA or the Natural Gas Act (NGA).[35] In addition, Merrill Lynch and Morgan Stanley argue that

[35] 15 U.S.C. § 717, et seq. (2000).

Market Behavior Rule 2(d) fails to differentiate between actions that affect market prices and those that do not. Merrill Lynch and Morgan Stanley argue that if a seller's actions do not affect market prices to an extent that renders these prices unjust and unreasonable, the Commission has no statutory authority to impose any sanctions on the seller.

2. Commission Ruling

87. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 2(d). Specifically, we will deny the requests made by Consumer Advocates and NASUCA to include within the scope of Market Behavior Rule 2(d) manipulative conduct other than overt collusion. In fact, the market abuses contemplated by Consumer Advocates and NASUCA will be addressed by our Market Behavior Rules to the extent these abuses are without a legitimate business purpose and are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products.

88. We will also deny Puget Sound, et al's request that we reject Market Behavior Rule 2(d) as redundant given the preamble requirement of Market Behavior Rule 2. While Puget Sound, et al. is correct in its analysis that a violation of Market Behavior Rule 2(d) would also constitute a violation of our preamble requirement (our anti-manipulation standard), the interplay between this preamble requirement and each of the four subparts of our rule is by design. The preamble requirement, as noted above, is constructed in such a way that it can apply to conduct whose specific form and nature may not be known today. The subparts of our rule, by contrast, are intended to apply to specific forms of conduct – in the case of Market Behavior Rule 2(d), to collusion.

89. We will also deny the requests for rehearing submitted by Merrill Lynch and Morgan Stanley. First, we disagree that Market Behavior Rule 2(d) fails to specify with sufficient particularity the behavioral elements that may be found to constitute collusion in a given case. For the reasons noted above with respect to the preamble requirement of Market Behavior Rule 2, we believe that sellers have been given adequate notice of the behavior prohibited by our rule. Moreover, for the reasons noted above, we decline to add greater specificity to a standard that will and must be relied upon in the future to prohibit manipulative acts or transactions whose precise form and nature cannot be envisioned today.

90. Finally, we decline to limit our prohibition to acts which may affect market prices. In fact, for the reasons noted in the Market Behavior Rules Order, our rule appropriately extends to the manipulation of market conditions and market rules, in addition to a seller's interference with market prices. Contrary to the assertions advanced by Merrill

Lynch and Morgan Stanley, the Commission is fully authorized under the FPA to regulate market conditions and market rules applicable to the wholesale electricity markets in which market-based rate sellers conduct their business.

H. Market Behavior Rule 3 (Communications)

Seller will provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, or Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercised due diligence to prevent such occurrences.

1. Requests for Rehearing and Clarification

91. EPSA requests clarification regarding the Commission's statement in the Market Behavior Rules Order that a jurisdictional entity requesting or receiving information covered by Market Behavior Rule 3 must be authorized to do so pursuant to its Commission-approved tariff or other Commission-approved authorizations. EPSA requests that the language of Market Behavior Rule 3 be modified to reflect this understanding.

92. Puget Sound, et al. argue that the requirement that sellers not omit material information in any communication covered by Market Behavior Rule 3 is vague and overbroad to the extent it may require sellers, in response to a Commission data request, to interpret the scope of the data request in a way that comports with the Commission's interpretation. Puget Sound, et al. requests that the Commission delete this requirement from Market Behavior Rule 3.

93. Merrill Lynch and Morgan Stanley and Mirant and Williams request clarification that Market Behavior Rule 3 prohibits market participants from knowingly submitting "false and misleading" information. Merrill Lynch and Morgan Stanley assert that in addition to this requirement, the Commission's rule should further specify that the information submitted be misleading on an issue that is material to the subject of the communication or submission and creates an artificial price. Merrill Lynch and Morgan Stanley also request revision of Market Behavior Rule 3 (as well as Market Behavior Rule 4) to specify expressly that sellers will not be found to have violated the Commission's rules for omissions that may occur due to a legal requirement to protect confidential information.

2. Commission Ruling

94. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 3. First, we reject EPSA's request that we modify our rule to apply only if the information at issue is requested or received pursuant to a Commission-approved tariff or other Commission-approved authorization. This clarification is unnecessary in those cases where the seller objects to the request on the grounds that the entity at issue does not have the authority to seek the information requested. In these circumstances, the seller can assert this defense without the clarification sought by EPSA. If, on the other hand, the seller voluntarily provides this information or complies with a Commission-authorized request to do so, Market Behavior Rule 3 should and will apply.

95. We will also reject the request for rehearing submitted by Puget Sound, et al. regarding the alleged vagueness of the requirement that sellers not "omit material information." While the term "material," in this context, may not be given to a precise before-the-fact definition in every case, we believe the seller will have sufficient notice regarding the requirements of our rule. First, materiality can be established with sufficient particularity by the seller by reference to Commission-approved rules and industry practices. In addition, sellers will also be accorded a safe harbor under our rule to allow for reasonable, unforeseen differences regarding the meaning of our requirement as it may be applied, i.e., our rule will not be applied against a seller shown to have exercised due diligence.

96. Finally, we will deny rehearing regarding the sufficiency of our due diligence allowance. Rehearing applicants urge that this due diligence standard be further strengthened (or simply replaced) by an express intent requirement and/or by similar qualifications that would have the effect of limiting the application of our rule in the case of certain false or misleading communications. In addition, Merrill Lynch and Morgan Stanley argue that a seller's omission of material information be excused in those circumstances where the omission is attributable to a legal requirement to protect confidential information. While we agree that a false or misleading communication (or omission of relevant information) may, in a given case, be excusable based on the facts and circumstances presented, we are not convinced that our due diligence standard would be inadequate for the purpose of considering such a defense. To the contrary, we believe that a due diligence defense will give sellers sufficient latitude to bring all relevant facts on this issue before the Commission in advance of any action which may be taken against the seller.

I. Market Behavior Rule 4 (Reporting)

To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas price indices, Seller shall provide accurate and factual information, and not knowingly submit false or misleading information or omit material information to any such publisher, by reporting its transactions in a manner consistent with the procedures set forth in the Policy Statement issued by the Commission in Docket No. PL03-3 and any clarifications thereto. Seller shall notify the Commission within 15 days of the effective date of this tariff provision of whether it engages in such reporting of its transactions and update the Commission within 15 days of any subsequent change to its transaction reporting status. In addition, Seller shall adhere to such other standards and requirements for price reporting as the Commission may order.

1. Requests for Rehearing and Clarification

97. TDU Systems alleges as error the Commission's failure to make its reporting requirement mandatory. TDU Systems argues that mandatory reporting is critical to maintaining the integrity of published price indices.

98. EEI and Duke request clarification regarding the Commission's adoption of a safe harbor standard for good faith reporting of transaction data to reporting agencies, concerning specifically the requirement that, in connection with this safe harbor allowance, each data provider "adopt and make public a clear code of conduct that its employees will follow in buying and selling natural gas or electricity and in reporting data from such transactions to index developers."[36] EEI and Duke request clarification that the provisions to be made public under this rule include only those provisions dealing with sellers' price reporting procedures, i.e., to those provisions addressing employee guidelines in reporting data from electricity and natural gas transactions to reporting agencies.

99. Merrill Lynch and Morgan Stanley request clarification regarding a seller's reporting obligations in those circumstances where the seller may be reporting trade data, at the request of an index publisher, for some but not all of its hubs, i.e., where not all of

[36] See Price Discovery in Natural Gas and Electric Markets, 104 FERC ¶ 61,121 at P 5, as clarified, 105 FERC ¶ 61,282 (2003) (Price Reporting Policy Statement).

the seller's hubs are part of the index. Merrill Lynch and Morgan Stanley request clarification that in this case, the Commission's safe harbor provisions will apply as to the hubs covered by the seller's reporting.

100. Finally, NASUCA challenges the Commission's safe harbor allowance, arguing that inadvertent errors should not be permitted to shield sellers from their obligations to provide just and reasonable rates to consumers.

2. Commission Ruling

101. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 4. First, we will deny the request for rehearing submitted by TDU Systems with respect to the issue of voluntary versus mandatory reporting. In our Price Reporting Policy Statement, we discussed at length why a mandatory reporting requirement would not be appropriate at this time, based, in part, on our reliance on a safe harbor allowance to induce voluntary reporting and based further on our need to actively monitor and assess the still-evolving approaches to price reporting now being actively considered by both price index developers and data providers.[37] Accordingly, we will not consider a mandatory reporting requirement in this proceeding. If further reporting requirements are developed, however, the seller's compliance with these requirements will be required under Market Behavior Rule 4.

102. We will also deny the request for clarification submitted by EEI and Duke concerning our requirement that, in connection with our safe harbor allowance, sellers will be required to adopt and make public a code of conduct to be followed by the sellers' employees in buying or selling natural gas or electricity and in reporting data from such transactions to index developers. While this requirement was set forth by the Commission in our Price Reporting Policy Statement, not in the Market Behavior Rules Order, we note here that the requirement clearly and unambiguously applies to employee guidelines relating to "buying or selling natural gas or electricity" (not just to personnel guidelines relating to the actual reporting function, as EEI and Duke urge). The scope of this requirement is appropriate, moreover, for all the reasons discussed in our Price Reporting Policy Statement, including the need for assurance that a seller's trading activities be kept separate from its reporting functions.

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[37] The Commission and the industry itself is still actively considering the policy options relating to this issue. On March 5, 2004, for example, the Commission's Staff issued a notice in Docket Nos. PL03-3-000 and AD03-7-000 soliciting comment on the current state of natural gas and electricity price formation.

103. We will also deny the request for rehearing submitted by Merrill Lynch and Morgan Stanley concerning our requirement that a seller who chooses to report any of its transactions to a price index developer will be required to report all of its transactions, including platform-facilitated transactions, to at least one index developer. This requirement, we have indicated, is made necessary in order to improve the accuracy, reliability, and transparency of price formation and is a condition to our safe harbor allowance.

104. Finally, we will deny rehearing regarding our adoption of our safe harbor allowance. For all the reasons discussed in our Price Reporting Policy Statement, this safe harbor has been adopted in order to encourage voluntary reporting. In the event our rule achieves that purpose, moreover, it will not invite market abuse nor will it allow market abuses to go undetected. To the contrary, our safe harbor allowance will serve as a rebuttable presumption only and will not shield or protect the intentional submission of false, incomplete or misleading information to index developers.

J. Market Behavior Rule 5 (Record Retention)

Seller shall retain, for a period of three years, all data and information upon which it billed the prices it charged for electric energy or electric energy products it sold pursuant to this tariff or the prices it reported for use in price indices.

1. Requests for Rehearing and Clarification

105. APPA and TAPS allege as error the Commission's failure to require sellers to retain the information and data that may be required to implement the grant of a disgorgement remedy in a given case. APPA and TAPS urge the Commission to revise Market Behavior Rule 5 to include the retention of all data and information relating to the seller's revenues and expenses.

106. EPSA and Puget Sound, et al. request clarification regarding the Commission's statement in the Market Behavior Rules Order that Market Behavior Rule 5 will not require sellers to retain cost of service or analytical data to reconstruct all sales made by the seller. EPSA requests that Market Behavior Rule 5 be revised to reflect this clarification expressly. Puget Sound, et al. request that the Commission further clarify that its data retention requirement includes only primary records used by the seller to bill its counterparties, including "confirms," metering data, and settlement documents, and does not extend to secondary records, including e-mails and internal memoranda that are not used for billing purposes.

107. Merrill Lynch and Morgan Stanley argue that Market Behavior Rule 5 should be revised to include an express reliance component, such that documents would be retained by sellers only to the extent that they were actually relied on by the seller to bill a counterparty for the energy sold.

2. Commission Ruling

108. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 5, our record retention rule. First, we reject rehearing applicants' argument that our rule requires further clarification or revision in order to implement the grant of an effective disgorgement remedy in a given case. Specifically, we do not believe that the retention of all data and information relating to the seller's revenues and expenses is necessary in order to deter the market abuses addressed by our rules or to provide an appropriate remedy in the event these rules are violated.

109. We also decline to clarify our rule further with the addition of such distinctions as primary versus secondary records and documents which may or may not have been expressly relied upon by the seller. Our rule requires sellers to retain all contractual and related documentation supporting the seller's billing statements (or its reported prices) relating to its market-based rate sales. If a given record includes information that fits this description, it must be retained for a period of three years, regardless of the medium in which the record is maintained (whether a contractual document, email, or other record). Accordingly, we need not make any additional distinctions between the innumerable forms in which these records could be classified or kept (e.g., primary versus secondary documents), or the extent to which the seller may have expressly relied on these records.

K. Market Behavior Rule 6 (Related Tariff Matters)

Seller shall not violate or collude with another party in actions that violate Seller's market-based rate code of conduct or Order No. 889 standards of conduct, as they may be revised from time to time.

1. Requests for Rehearing and Clarification

110. APPA and TAPS allege as error the Commission's exclusion from its rule of certain standards of conduct other than an Order No. 889 standard of conduct. APPA and TAPS note that there may be Commission-approved standards of conduct other than those approved pursuant to Order No. 889 and that these standards should also be included within the reach of Market Behavior Rule 6.

111. Merrill Lynch and Morgan Stanley note that Order No. 889 does not apply to a power marketer that is not affiliated with a transmission provider and therefore request clarification that Market Behavior Rule 6 does not impose on non-affiliated power marketers a requirement to comply with Order No. 889. In addition, Merrill Lynch and Morgan Stanley assert that non-affiliated power marketers should not be required to include this rule in their market-based rate tariffs.

2. Commission Ruling

112. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 6. Our rule simply clarifies that sellers' conduct in the wholesale electricity markets in which they do business must be consistent with (and fully adhere to) the seller's electric power sales code of conduct, as set forth in seller's market-based rate tariff or rate schedule, as well as seller's Order No. 889 standards of conduct. As such, the concern expressed by APPA and TAPS that there may be additional Commission-approved codes of conduct to which the seller may also be subject is beyond the scope of our rule. To the extent that remedies and procedures may need to be clarified, in the future, with respect to any such additional tariff requirements, we will provide the appropriate forum for interested parties to have their views heard on such matters.[38]

113. In addition, we need not enumerate in the language of our rule the entities for whom this rule may not apply in a given case, including power marketers that may not be subject to Order No. 889. If a seller is not subject to Order No. 889, it will not be subject to our rule as it relates to a standards of conduct requirement issued pursuant to that order.

L. Market Behavior Rules and Other Requirements Not Adopted By the Commission in the Market Behavior Rules Order

The Market Behavior Rules Order declined to adopt various rules proposed by intervenors as an alternative to our Market Behavior Rules, including new rules designed to address transmission congestion, market power, and the overall competitiveness of the wholesale electricity market. We noted

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[38] See, e.g., Order No. 2004, 68 Fed. Reg. 69, 134 (Dec. 11, 2003), III FERC Stats. & Regs. ¶ 31,155 (Nov. 25, 2003), order on reh'g, Order No. 2004-A, 107 FERC ¶ 61,032 (2004). We also note that Market Behavior Rule 1 would be applicable to any Commission-approved standards of conduct that are not otherwise addressed by Market Behavior Rule 6.

> *that while these structural issues represent a critical element of a competitive market, and would continued to be pursued by the Commission in the appropriate proceeding, including proceedings currently pending before the Commission, the potential for market abuse (and thus the need for our Market Behavior Rules) will continue to exist even in a structurally competitive market.*

1. Requests for Rehearing and Clarification

114. APPA and TAPS assert that in not adopting a more comprehensive set of rules and regulations applicable to the marketplace as a whole, in addition to (or in lieu of) our Market Behavior Rules, the Market Behavior Rules Order erred. The Consumer Advocates also challenge the scope of the Commission's undertaking in this proceeding, asserting that the assumption on which the Commission's Market Behavior Rules stand, i.e., that market-based rates can be just and reasonable, must be rejected on legal grounds as inconsistent with the FPA.

115. Other intervenors assert that the Commission erred in the Market Behavior Rules Order by not addressing various other issues. APPA and TAPS allege that the Commission erred by not requiring greater transparency with respect to market information and data and by not requiring that the information which currently is made available in ISO/RTO markets be made available on a real-time or next-day basis. Merrill Lynch and Morgan Stanley allege as error the Commission's failure to apply its Market Behavior Rules to market operators and LSEs.

116. In addition, the California Commission alleges as error the Commission's failure to expressly prohibit hockey stick bidding as one of its subparts to Market Behavior Rule 2, i.e., a bidding pattern where the last megawatt bid from a unit is made at an excessively high price relative to other bids attributable to the unit, or where a single unit in a portfolio is bid at an excessively high level compared to the remainder of the seller's portfolio.

117. Finally, Consumer Advocates and NASUCA allege as error the Commission's determination to reject proposed subpart (e) of Market Behavior Rule 2.[39] Consumer Advocates argue that this manipulation standard was appropriate because it would have

[39] As proposed in the June 26 Order, Market Behavior Rule 2(e) would have prohibited sellers from "bidding the output of or misrepresenting the operational capabilities generation facilities in a manner which raises market prices by withholding available supply from the market."

addressed strategic bidding behavior as well as economic withholding in the wholesale bilateral contract markets. NASUCA asserts that the proposed rule was not redundant with Market Behavior Rule 1, which may not apply to economic withholding.

2. Commission Ruling

118. We will deny rehearing of the Market Behavior Rules Order with respect to those issues not addressed or adopted by our order. First, for the reasons cited in the Market Behavior Rules Order,[40] we decline to address in the context of this proceeding, where our focus is on seller conduct relative to the industry as a whole, issues related to the structure and operation of specific markets, including the duties and functions performed in these markets by RTOs, ISOs, other transmission providers, LSEs, or by market participants. As such, we deny the rehearing requests made with respect to these issues by APPA and TAPS, Consumer Advocates, and Merrill Lynch and Morgan Stanley.

119. We will also deny the request made by the California Commission to include, as an express form of market manipulation under the subparts of Market Behavior Rule 2, the practice of hockey-stick bidding. Rules relating to specific bidding behaviors within organized markets with a prescribed bidding regime should be considered as a component of the particular rules and requirements of that power market. The rules and requirements associated with such a regime are particular to these markets and should be clearly established in the tariff governing that market.[41] Such market issues are not properly addressed in these rules of general applicability.

120. Finally, we will deny the requests for rehearing submitted by Consumer Advocates and NASUCA regarding our determination in the Market Behavior Rules Order to reject subpart (e) of Market Behavior Rule 2, as proposed in the June 26 Order. For the reasons cited in the Market Behaviors Rule Order,[42] proposed subpart (e) of Market Behavior Rule 2 addressed biding into organized markets in violation of the Commission-approved rules applicable in these markets. As such, the proposed rule was redundant with Market Behavior Rule 1. Moreover, to the extent Consumer Advocates and NASUCA may have interpreted proposed subpart (e) as applying in a broader context not encompassed by a Commission-approved rule or regulation of the applicable power market (i.e., not

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[40] See Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 137-38.

[41] For example, the bidding regime within CAISO's market will be addressed in the pending CAISO market redesign proceeding in Docket No. ER02-1656.

[42] Id. at PP 99-102.

encompassed by Market Behavior Rule 1), manipulative conduct, in this context (including economic withholding and strategic bidding behavior) could still be actionable in a given case under the general manipulation standard set forth in Market Behavior Rule 2.

M. Remedies

In the Market Behavior Rules Order, we found that any violation of our Market Behavior Rules will constitute a tariff violation. We also held that in connection with any such violation, seller would be subject to disgorgement of unjust profits associated with the tariff violation, from the date on which the tariff violation occurred. In addition, we held that seller may also be subject to suspension or revocation of its authority to sell at market-based rates or to other appropriate non-monetary remedies.

1. Requests for Rehearing and Clarification

121. Rehearing applicants seek to either narrow the range of remedies available in connection with a seller's violation of our Market Behavior Rules or, conversely, seek to expand these available remedies. With respect to those rehearing applicants seeking to limit these remedies, Duke asserts that reliance on a disgorgement remedy will harm rather than advance the Commission's goal of robust competitive markets and, in addition, will defeat the Commission's stated goal of promoting transaction finality.

122. Duke also seeks clarification that to the extent its rehearing request on this issue is denied, the Commission, in exercising its discretion to order refunds for behaviors not specifically prohibited by our rules, will place significant weight on the degree to which the violation is self-evident. In addition, Duke seeks clarification that refunds, if ordered, will be limited to those portions of transactions within the applicable quarter in which the Commission makes a finding of a conduct violation, such that if the Commission finds that a conduct violation occurred during one hour of a daily transaction, refunds would be limited to that single hour.

123. In addition, EEI requests clarification that in the case of a technical rule violation that may not warrant disgorgement of profits or other serious penalties, the Commission will take a reasonable approach when determining whether a complaint is worth pursuing and in determining a fair and equitable remedy. Puget Sound, et al. request clarification that a violation of the Commission's rules by an individual seller in a single price auction market will not give rise to an obligation on the part of all sellers in that market to re-price their transactions.

124. Other rehearing applicants allege as error the Commission's failure to impose a broader monetary liability on sellers found to have violated the Commission's Market Behavior Rules. The Cal Oversight Board, NASUCA and TDU Systems, for example, argue that sellers should be required to make the market whole in these circumstances because a more narrowly tailored disgorgement remedy (focusing only on the transaction to which the seller's violation may be attributable) will fail to provide an adequate deterrent to improper behavior.

125. APPA and TAPS also allege as error the Commission's conclusion in the Market Behavior Rules Order that disgorgement of unjust profits and the possible revocation of a seller's market-based rate authority will suffice to induce compliance with the Commission's Market Behavior Rules. APPA and TAPS argue, to the contrary, that the upside potential of profitable manipulation outweighs the costs associated with the Commission's remedies. Consequently, APPA and TAPS recommend that in the case of a Market Behavior Rule violation, a seller should be required to disgorge all profits realized by both the seller and its affiliate in connection with the violation and that this disgorgement requirement not be limited to the specific transactions through which the manipulation occurred. In addition, APPA and TAPS propose that a seller be subject to penalties that represent multiples of its ill-gotten profits, similar to those approved by the Commission with respect to over-scheduling.[43] APPA and TAPS further argue that the proceeds from these remedies should be directed to those consumers who paid higher prices as a result of the abuse.

126. The California Commission alleges that the Commission failed to adequately explain the basis for its determination that a disgorgement remedy in lieu of any other monetary remedies should be regarded as appropriate. In addition, the California Commission argues that the Commission's limitation of remedies unlawfully conflicts with the FPA because it unreasonably fails to protect consumers and diverges, without explanation, from the Commission's general policy of providing refunds.

127. Finally, Sempra requests clarification that the Commission's behavioral rules, as applied, will not narrow the protections afforded to contracting parties under the Mobile-Sierra public interest standard of review[44] (where the contracting parties have chosen to

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[43] See APPA and TAPS request for rehearing at 20, citing Allegheny Power Corp., et al., 80 FERC ¶ 61,143 at 61,545 (1997) (order approving buyer penalty for taking more service than reserved equal to the applicable rate plus 100 percent).

[44] See United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) and Federal Power Commission v. Sierra Pacific Co., 350 U.S. 348 (1956).

rely on such protection) and thus will not serve as grounds for contract modification, absent a finding that the contract is the direct result of the alleged violation and that engaging in the alleged violation directly affects the fairness and good faith of the parties at the contract formation stage.

2. Commission Ruling

128. We will deny rehearing regarding our determinations in the Market Behavior Rules Order with respect to the appropriate remedies that should be made available to market participants in connection with a seller's violation of our Market Behavior Rules. In making these determinations, we appropriately balanced the need of a seller for regulatory certainty (and transaction finality) with the needs of the Commission, in the fulfillment of its statutory duties, to ensure compliance with our rules and the needs of market participants to have an appropriate remedy in the case of a loss attributable to the seller.

129. Thus, we held that a remedy limited to a disgorgement of the seller's unjust profits would be an appropriate remedy.[45] First, we noted that this remedy would not constitute a retroactive refund because our Market Behavior Rules establish clear advance guidelines to govern market participant conduct. Moreover, we found that in approving these Market Behavior Rules and requiring sellers to be fully accountable for any unjust gains attributable to their violation, we would not foreclose our reliance on existing procedures or other remedial tools, as may be necessary, including generic rule changes or the approval of new market rules applicable to specific markets.[46]

130. We also rejected commenters' assertions that a disgorgement remedy may be difficult to calculate in a particular case, or may operate as a chill on the market in other circumstances. The concerns raised by commenters, we noted, are speculative at best. Moreover, we stated that any such concerns can be fairly evaluated by the Commission

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[45] See, e.g, Coastal Oil & Gas Corp. v. FERC, 782 F.2d 1249 (1986) (revenues collected through a seller's market manipulation in excess of a just and reasonable rate may be subject to disgorgement).

[46] If Congress grants the Commission additional remedial power, including the authority to levy civil penalties, the Commission will, in addition to the remedies set forth herein, implement such authority and utilize it when appropriate for violations of these Market Behavior Rules. We strongly endorse Congressional legislation that would provide the Commission with additional civil penalty authority for violations of our orders, rules and regulations.

on a case-by-case basis, with a full opportunity for input from all interested parties. Thus, we found that we need not reject a disgorgement remedy in all cases simply because it may be inappropriate to apply (and need not be imposed) in a specific case.

131. We also rejected commenters' assertions that, in enforcing our Market Behavior Rules, the Commission should consider a make-the-market-whole remedy. We noted that the remedies we were adopting included the possible revocation of Sellers' market-based rate authority. We found that these remedies would provide a sufficient inducement for sellers to comply with our rules.

132. On rehearing, we decline to modify or otherwise rescind these determinations. Specifically, we will not lessen on a categorical basis, as proposed, the potential consequence for a rule violation, as advocated by Duke, EEI, and Puget Sound, et al., nor will we subject the seller to the possibility of stiffer penalties, as proposed by the Cal Oversight Board, NASUCA, TDU Systems, the California Commission, and APPA and TAPS. In fact, the remedies we adopted in the Market Behavior Rules Order strike a careful balance between these respective interests. Moreover, we reject Duke's renewed assertion that these remedies will cast a chill on the industry. To the contrary, we found in the Market Behavior Rules Order and reiterate, here, that our Market Behavior Rules and the remedies we have specified in the case of violations will foster greater consumer confidence in the operation of the wholesale market, promote competition, and assist the Commission in the performance of its statutory duties.

133. We will also deny Duke's request that we limit refunds in the case of a rules violation to the quarterly period in which the violation is found to have occurred. While we are mindful of the seller's need for transaction finality, as a general proposition, the balance of interests in this particular context may require us to extend our disgorgement remedy to the entirety of the seller's improperly-obtained revenues, i.e., to those revenues found to be in excess of those that would have been garnered absent manipulation.

134. However, we will grant the clarification sought by Duke regarding the discretion that will be exercised by the Commission in enforcing its rules. In exercising its discretion to determine the appropriate remedy for the violation of our rules, we will take into account factors such as how self evident the violation is and whether such violation is part of a pattern of manipulative behavior in considering the facts and circumstances of the case.

135. Finally, we will grant, in part, the clarification sought by Sempra. Our Market Behavior Rules are not intended to narrow the protections afforded to a contracting party under the Mobile-Sierra public interest standard of review in the case of a proposed contract revision.

N. Complaint Procedures

Complaints alleging any violation of the Commission's Market Behavior Rules will be subject to the remedies and procedures set forth in Appendix B to the Market Behavior Rules Order. The Appendix B procedures specify, among other things, that complaints seeking relief for a market behavior rule violation shall be made no later than 90 days after the end of the calendar quarter in which the violation is alleged to have occurred. In addition, Appendix B specifies that the Commission will act within 90 days from the date it knew of an alleged violation or knew of the potentially manipulative character of an action or transaction.

1. Requests for Rehearing and Clarification

136. TDU Systems, the Cal Oversight Board, and APPA and TAPS allege as error the Commission's determination in the Market Behavior Rules Order to impose a 90-day deadline for complaints seeking, as a remedy, disgorgement of unjust profits. TDU Systems and APPA and TAPS assert that, at a minimum, this time allowance should be extended to 180 days. The Cal Oversight Board proposes that the Commission's limitation period be revised to one-year from the date the complainant knew or, upon the exercise of due diligence, should have known of the wrongful conduct, but no later than two years after the date of the transaction.

137. The California Commission argues that imposing complaint limitations periods frustrates the purpose of the FPA and subjugates the pubic interest to private suppliers. The California Commission further asserts that while the remoteness of an alleged violation can and should be considered in determining the scope of relief, a limitations period cannot be relied upon to defeat the right of market participants to a just and reasonable rate and the enforcement of a filed rate. The California Commission also takes issue with the Commission's requirement that it will act within 90 days from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative character of an action or transaction. The California Commission submits that this requirement is impermissibly vague because there is no indication regarding how specific the allegation must be in order to constitute knowledge. The California Commission suggests that in order to constitute "knowledge," the allegation should be communicated in writing with sufficient specificity to identify the participants, transactions and dates of the alleged behavior. The California Commission also requests clarification that when the Commission initiates an investigation under its Market Behavior Rules on its own, it will do so in a public manner that affords buyers and state regulatory authorities access to information and an opportunity to be heard.

138. EEI, Duke, Puget Sound, et al., Cinergy, Sempra, Merrill Lynch and Morgan Stanley, and Mirant and Wiliams also seek rehearing of the Commission's complaint procedures, arguing that these procedures will impose an undue hardship on sellers, absent the various revisions and/or clarifications these intervenors seek. Sempra argues that the Commission's 90-day complaint deadline should be applied without exception. EEI, on the other hand, supports the Commission's "should not have known" allowance applicable to market participant complaints, but argues that this exception to the 90-day rule should be subject to a reasonable time limit and require a showing of actual harm to the complainant. Puget Sound, et al. requests clarification that any complaint filed after the 90-day period carry a heavy burden in demonstrating that the complainant could not have known of the violation within the 90-day period.

139. Cinergy alleges as error the Commission's failure to include assurances that a complainant bears the burden of proof to come forth with specific facts and allegations that present a prima facie case before any such proceeding will be instituted against a seller.[47] Merrill Lynch and Morgan Stanley suggest that complainants be required to specifically state in their complaint the transactions that allegedly violate the Commission's rules and quantify that alleged harm attributed to the violation. Cinergy also requests clarification that an expedited procedure will be utilized to allow the Commission to act definitively and with dispatch on a complaint, so that disruption and harm to both the market and the market participant can be minimized.

140. Duke asserts that the period for refunds from all investigations, through formal complaints or Commission actions initiated by communications from persons that could have filed a complaint, should be measured on the same basis, i.e., that such communications must occur within 90 days of the end of the calendar quarter to preserve retroactive refunds as a penalty. In addition, Duke recommends that the Commission adopt a date certain, one year after the end of the applicable calendar quarter, after which no refunds will be ordered. Duke also urges the Commission to include within its procedures a requirement to promptly inform the seller of the initiation of an investigation.

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[47] Duke seeks clarification regarding this same issue, arguing that complaint alleging a market behavior rule violation should be adjudicated in accordance with the Commission's existing complaint procedures, including the requirement that a complainant make out a prima facie case as a pre-condition to Commission action on the complaint.

141. Duke also requests clarification regarding the mechanisms that will be utilized by the Commission to clarify the specific application of its Market Behavior Rules on a going-forward basis. Duke asserts that given the significant market uncertainty engendered by the Commission's Market Behavior Rules, the Commission should establish a formal mechanism for market participants to obtain prompt guidance on specific activities or situations identified over time, including but not limited to staff opinion letters, technical conferences, and streamlined procedures to seek declaratory rulings.

142. EEI and EPSA seek clarification that the Commission will not allow complainants to bypass time limits by making anonymous complaints, either through the hotline or by other means. EPSA requests that the Commission direct its staff to ensure that any allegations of market behavior violations made through the Hotline or informal communications be subject to a due diligence process to determine whether the complaint was made in a timely and acceptable manner. Mirant and Williams assert that the Commission should not initiate an action at the behest of a market participant or other interested party who failed to initiate a complaint proceeding or otherwise failed to take steps to inform the Commission of an alleged violation within the prescribed time period.

143. EEI also requests clarification that the Commission will only take prospective action against a seller in those circumstances where the Commission's knowledge of a violation has been acquired by an entity that "should have known" of the violation within the 90-day rule. EEI and Mirant and Williams also asserts that any type of communication with the Commission (including communications made by market monitors), not just communications with enforcement Staff, should constitute knowledge on the Commission's part for purposes of triggering the Commission's 90-day complaint limitation period. Mirant and Williams propose to further extend this imputed knowledge limitation to "any other means by which the Commission or Commission Staff receives or generates information reasonably suggesting that a violation has occurred."

144. In addition, Mirant and Williams propose that to the extent such information is provided to the Commission or to enforcement Staff by a potential third party complainant, no action should be permitted by the Commission unless this information was provided to the Commission or to enforcement Staff within the time period proscribed for complaints.

145. Finally, the California Commission, the Cal Oversight Board, the New England Conference of Public Utilities Commissioners, the Vermont Department of Public Service, and the Michigan Public Service Commission (NECPUC, et al.), and the Sacramento Municipal Utility District (SMUD) request special exemptions with respect to our complaint limitations period as it would apply to governmental entities and/or non-market participants.

2. Commission Ruling

146. We will deny rehearing of the Market Behavior Rules Order as it relates to our Appendix B complaint procedures. Specifically, we decline to modify our 90-day time limitation on complaints or our specified exceptions to this limitations period. These complaint procedures strike a reasonable balance between the interests of sellers and the market as a whole, for all the reasons noted in the Market Behavior Rules Order.

147. While the Commission has acknowledged the importance of rate certainty in the form of transaction finality, the need for rate certainty must, in this instance, be balanced against the fact that many market abuses are not immediately apparent and market participants may need time to discover and verify that abuses have occurred. Our complaint limitation procedures provide this necessary balance to protect the interests of sellers, on the one hand, and those who may have been adversely affected by violations of our Market Behavior Rules that may not be readily apparent. As we recognized in the Market Behavior Rules Order, our complaint limitation procedures have been designed to provide a reasonable balance between encouraging due diligence in protecting one's rights and finality in transactions.

148. Our Appendix B allowance that the 90-day time-limit will be deemed to have run after 90-days of an alleged act unless the "complainant can show that it did not know and should not have known of the behavior which forms the basis for its complaint" is an important part of the balance reached by the Commission. This language ensures that a reasonable person exercising due diligence will have sufficient time to discover hidden wrongful conduct and to submit a claim within an appropriate timeframe. The party initiating a complaint after this time limit has run will be required to make an adequate showing to convince the Commission that it could not have known of the alleged violation during the 90-day period following the calendar quarter in which the violation occurred.

149. The Commission, unlike the market participants who may be buyers or otherwise directly affected by a transaction, may not be aware of actions or transactions that potentially may violate our rules. Therefore, the Commission will act within 90 days from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative character of an action or transaction.

150. Furthermore, the Commission will not require that a specific procedural forum be established solely for the enforcement of these rules. Rather, the Commission will act on any properly filed complaint under its existing complaint procedures. In addition, the Commission may act on information received via its Hotline procedures and establish investigations based upon such information if it finds sufficient substance to the allegations to warrant further investigation. As such, we will grant the requests for

clarification submitted by Cinergy and Duke, regarding the applicability of these procedures to complainants' burden of proof obligations. In any complaint filed before the Commission, the complainant carries the burden of proof regarding the facts and law asserted, consistent with the Commission's existing complaint procedures.

151. We will deny the California Commission's request that we provide public procedures relating to Commission Staff's internal investigations. For the protection of all market participants, it is essential that the Commission's own internal investigations retain the degree of confidentiality currently embodied in our rules and policies.

152. We also decline to enumerate special rules applicable to summary judgment rulings or burden of proof determinations in complaint proceedings raising alleged Market Behavior Rule violations. In fact, the Commission's existing rules of practice and procedure will suffice in this regard. In addition, while we recognize Duke's concerns that complaints be processed on a timely basis, we decline to commit the Commission to a specified timetable in advance of our consideration of the facts and circumstances that may be presented in a given case. Similarly, while EEI and EPSA raise concerns regarding the potential abuse of our hotline procedures, the Commission is fully capable of ferreting out such abuse on a case-by-case basis.

153. Finally, we decline to approve special complaint procedures applicable to governmental entities and/or non-market participants. In fact, we are satisfied that our complaint procedures and the Market Behavior Rules to which they apply will give all interested parties and the Commission itself a reasonable opportunity to monitor potential market abuses and, when appropriate, seek relief in the case of an alleged violation.

O. Section 206 Authority

The Market Behavior Rules Order found that the Commission is not barred by section 206 of the FPA from approving Market Behavior Rules applicable to market-based rate sellers, or allowing as a remedy the disgorgement of unjust profits. Specifically, the Market Behavior Rules Order rejected the arguments made by intervenors that the potential financial consequences for sellers found to be in violation of the Commission's Market Behavior Rules would violate the refund limitations set forth in section 206(b) of the FPA.[48]

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[48] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 159-162. Section 206(b) requires that any refunds made in a section 206 proceeding initiated by the Commission on its own motion be based on a refund effective date no earlier than 60 days after the publication by the Commission of notice of its intent to initiate such a proceeding, or, in the case of a complaint, no earlier than 60 days after the complaint was

(continued)

1. Requests for Rehearing

154. Cinergy, Duke, and Mirant and Williams argue that the Commission's disgorgement remedy violates section 206 of the FPA. Cinergy argues that the Commission has exceeded its authority under section 206 by setting forth overly-broad and unduly vague tariff conditions that, when and if applied in a future case against a particular seller, will impose on that seller the functional equivalent of a retroactive refund liability. Cinergy submits that use of the Commission's conditioning authority in this way, to apply in the future an amorphous standard that cannot be defined today, effectively writes the prospective limitations of section 206 out of the FPA. Cinergy argues that, in fact, section 206 provides a specific time frame under which past and final transactions cannot be unraveled. Duke agrees, asserting that the Commission's disgorgement remedy would, in effect, use the Commission's conditioning authority to set the filed rate for the first time on a retroactive basis, or do indirectly what the Commission may not do directly.

155. Cinergy further argues that by attempting to impose on sellers overly vague tariff conditions that can only by defined with particularity in the future, the Commission is effectively and unlawfully circumventing the burden of proof requirements of section 206. Cinergy notes that in a section 206 proceeding, the Commission (or in the case of a complaint proceeding, the complainant) bears the burden to prove that a rate charged under the tariff is unjust and unreasonable and that some new rate is just and reasonable.

156. Consumer Advocates and Cinergy also allege that the Commission has not satisfied its section 206 burden in this case by demonstrating that its Market Behavior Rules are just and reasonable. Cinergy asserts that this finding has not been made with respect to every market, every product, and every seller in the country. Consumer Advocates adds that the Market Behavior Rules Order, in adopting only guidelines regarding market participant conduct, fails to "fix" a particular rate as section 206 requires.

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filed. Section 206(b) also limits the refund effective period to five months after the expiration of such 60-day period.

2. Commission Finding

157. We will deny the requests for rehearing seeking to nullify our Market Behavior Rules in their entirety based on the asserted requirements of section 206 of the FPA. In fact, section 206 of the FPA (and the section 206 procedures followed by the Commission in this proceeding), fully authorize and support our adoption of our Market Behavior Rules for all the reasons previously noted by the Commission in the Market Behavior Rule Order. As such, the rehearing requests on this issue, which raise many of these same arguments again, have already been addressed and rejected by the Commission.

158. Specifically, in the Market Behavior Rules Order, we explained in detail that our Market Behavior Rules would operate as a set of conditions, on a going-forward basis, to sellers' grant of market-based rates authority and that the Commission, in adopting these conditions, has broad authority to ensure that the rates subject to our jurisdiction are within a zone of reasonableness. For these same reasons, we also held that the adoption of our Market Behavior Rules (and their future enforcement in a given case) would not violate the filed rate doctrine. The "filed rate," in this case, will be the behavioral standards voluntarily incorporated into the seller's tariff as an agreed condition relating to its grant of market-based rate authority.

159. In the Market Behavior Rules Order, moreover, we also addressed and rejected the argument that our disgorgement remedy would violate the refund limitations set forth in section 206(b) of the FPA. Specifically, we noted that we had initiated this proceeding under section 206 for the purpose of examining whether sellers' market-based rate tariffs are just and reasonable, or whether, conversely, they should be revised as we had proposed. Because we found that sellers' currently effective tariffs are unjust and unreasonable, or may lead to unjust and unreasonable rates without the inclusion of our proposed Market Behavior Rules, we were acting within our statutory authority when we further concluded that these tariffs should and must be revised. In ordering these revisions, moreover, we did so on a prospective basis, as section 206 requires.

160. We also noted that the Commission has the authority to impose the appropriate remedy where it finds that a violation of a Commission-approved rule has occurred. As such, we rejected the argument that a violation of an existing condition of service, e.g., one of our Market Behavior Rules, could not be remedied by the Commission from the

time the violation was found to have occurred. We noted that the courts have upheld our authority in this regard in the fully analogous context presented by the Natural Gas Act (NGA).[49]

161. We also clarified that our Market Behavior Rules Order was based on our findings of fact and the record evidence presented in this proceeding supporting our finding that sellers' existing tariffs are unjust and unreasonable under section 206. We noted that in any proceeding brought to enforce our Market Behavior Rules, the issue would be whether the seller at issue has violated its tariff. We found that, as such, the seller would have sufficient notice of the conditions required for service at the time of the implementation of the service conditions and that the Commission would be entitled, at its discretion, to fashion an appropriate remedy. For all these reasons, we decline to modify or rescind, on rehearing, our determination in the Market Behavior Rules Order that our Market Behavior Rules have been adopted and designed consistent with the requirements of section 206.

P. Coordination of Enforcement Responsibilities as Between the Commission and a Commission-Approved Market Monitoring Unit

The Market Behavior Rules Order provided guidance concerning the application and enforcement of the Commission's Market Behavior Rules relative to ISO/RTO rules. The Commission found that it was appropriate to authorize Market Monitoring Units (MMUs) to enforce certain ISO/RTO tariff matters if those matters are: (i) expressly set forth in the tariff; (ii) involve objectively-identifiable behavior; and (iii) do not subject the seller to sanctions or other consequences other than those expressly approved by the Commission and set forth in the tariff. The Commission held that beyond this defined MMU authority, sellers' behavior will be subject to direct Commission enforcement in the first instance, regardless of whether the behavior occurs in ISO/RTO administered markets or bilateral markets.[50]

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[49] See Consolidated Gas Transmission Corp., et al., 771 F.2d 1536 (D.C. Cir. 1985) (holding that the Commission has the authority under section 16 of the NGA to order retroactive refunds to enforce conditions in certificates).

[50] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 180-186.

1. Requests for Rehearing

162. TDU Systems and APPA and TAPS object to the Commission's determination that where an MMU finds a specific behavior not to be in violation of the applicable ISO/RTO tariff (and this determination is not appealed to the Commission), the seller will not be exposed, thereafter, to a subsequent Commission enforcement action involving the same matter. TDU Systems and APPA and TAPS charge that this enforcement limitation will handicap the ability of market participants to bring enforcement actions that may come to their attention and may also prohibit the Commission from carrying out its own enforcement responsibilities. APPA and TAPS further point out that in most cases, an aggrieved party may not even be aware that the MMU has rendered a determination regarding a particular seller. APPA and TAPS argue that, at a minimum, if MMU decisions will be preclusive, then like Commission staff decisions, there should be public notice so that market participants have an opportunity to decide whether to take an appeal to the Commission.

163. APPA and TAPS also assert as error the Commission's failure to require market-based rate sellers to subject themselves to the authority of regional market monitors, especially in regions without organized ISO/RTO markets. APPA and TAPS argue that the Commission's ability to enforce its Market Behavior Rules will be seriously compromised in the non-ISO/RTO markets if it does not require regional market monitors.

164. Finally, Cinergy argues that the delegation of authority granted by the Commission to MMUs, including adjudicatory penalty authority, is improper and that such a delegation infringes on a seller's administrative due process rights. Cinergy argues that the Commission should not assign to MMUs any authority to render conclusions about market participant conduct.

2. Commission Ruling

165. We will deny rehearing of the Market Behavior Rules Order concerning RTO/ISO coordination issues and market monitoring matters. In the Market Behavior Rules Order, we clarified the respective duties and functions of the Commission and the MMUs, particularly with respect to initial actions regarding certain tariff violations. Specifically, we found that MMUs may administer compliance with certain tariff provisions where it is: expressly set forth in the tariff; the tariff provision involves objectively-identifiable behavior; and the MMU does not subject the seller to sanctions or other consequences other that those expressly approved by the Commission and set forth in the applicable tariff, subject to the right of appeal to the Commission. We further noted that if the MMU action was not appealed, or the MMU chose not to take action, the seller would not be exposed to subsequent Commission action with respect to the conduct at issue. In

discussing the role of MMUs, we also referred to our MMU Communications Order, in which we stated that MMUs "are practically an extension, or a surrogate for, the Commission's own monitoring and investigative staff."[51] While we have used such language to characterize the role of the MMUs in the past, we clarify here that MMU personnel are not a substitute for Commission enforcement Staff. They are RTO employees or contractors, not Commission Staff. The ability of MMUs to take actions with respect to certain tariff compliance matters is akin to tariff compliance administered by personnel of other types of public utilities or jurisdictional gas pipelines (for example, Commission-approved tariffs may authorize a pipeline or public utility to issue operational flow orders). Unlike other public utilities, however, MMUs have a unique dimension to the scope of their activities since they are a key component of the market monitoring plans that the Commission has required RTOs/ISOs to develop and implement. We expect the conduct of the RTO/ISO market monitoring function to be such that the Commission and its staff can be informed by the information obtained by the MMU so that the Commission can take the appropriate action under the FPA.

166. Because the tariff compliance administered by the MMU pertains only to matters that are: (i) expressly set forth in the tariff; (ii) involve objectively-identifiable behavior; and (iii) do not subject the seller to sanctions or other consequences other than those expressly approved by the Commission and set forth in the tariff, the actions taken by the MMU, in this context, will not be based on an unauthorized grant of authority or involve the exercise of subjective judgments. Thus, in accordance with these guidelines, we confirm that actions taken by the MMU will not be subject to our further review, absent the filing of an appeal or a complaint. In addition, similar to the Commission's own practice with respect to preliminary investigations, we will not require the MMU to issue a "no action" notice confirming its determination to close out an investigation that it may have begun (but not pursued) against any given seller.

167. We also decline to use this proceeding as a vehicle to create MMUs for regions that do not have organized markets. Our clarifications regarding market monitoring matters, in the Market Behavior Rules Order, were intended to address how existing and future MMUs in organized markets would interface with the Commission in the context of our Market Behavior Rules. These clarifications were not intended to establish market monitors for non-RTO/ISO regions. As such, we deny the rehearing requests of APPA and TAPS proposing that such monitors be established. In fact, our Market Behavior Rules and the procedures we have adopted with respect to their enforcement represent a

[51] See Communications with Commission-Approved Market Monitors, 102 FERC ¶ 61,041 at 61,091 (MMU Communications Order), order denying reh'g, 103 FERC ¶ 61,151 (2003).

significant step forward in assuring that wholesale electricity rates are and will remain just and reasonable in both RTO/ISO markets as well as RTO/ISO markets.

168. The issues raised in this proceeding have caused us to further consider the appropriate role and structure of MMUs. As such, we have begun reviewing the various tariff provisions concerning MMUs in RTO and ISO markets. Accordingly, while we have included preliminary guidance in this proceeding regarding the role of the MMU and its relationship to the Commission, we are in the process of a thorough evaluation of this issue. We expect our review to lead to a Policy Statement through which we will clarify and rationalize the MMU's role across RTOs and ISOs and in relationship to the Commission.

169. Finally, we disagree with Cinergy that giving the MMU the responsibility to make decisions in the first instance with respect to certain tariff violations is a violation of a seller's due process rights. No MMU sanction can be imposed except as permitted by the terms of a Commission-approved tariff. Moreover, any MMU sanction in such matters is appealable to the Commission and only the Commission can ultimately act with respect to any contested sanction. Due process will be provided both before the MMU and in any appeal to the Commission.

The Commission orders:

(A) The requests for rehearing of the Market Behavior Rules Order are hereby rejected, as discussed in the body of this order.

(B) The requests for clarification of the Market Behavior Rules Order are hereby granted, in part, and denied in part, as discussed in the body of this order.

By the Commission. Commissioner Brownell concurring with a separate statement attached.

(S E A L) Commissioner Kelly concurring in part and dissenting in part with a separate statement attached.

Linda Mitry,
Acting Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations — Docket No. EL01-118-003

(Issued May 19, 2004)

Nora Mead BROWNELL, Commissioner *concurring*:

1. Market Behavior Rules 2(b), 2(c), and 3 provide that if the seller can establish that it exercised due diligence to prevent a violation, it will not be held liable. The order appropriately rejects requests to provide specific guidance on the application of this due diligence defense. There is a wide range of factors relevant to establishing whether a seller has exercised due diligence in a particular case—the existence of procedures designed to prevent violations, the history of seller's enforcement of such procedures, and the pervasiveness of the violations, to name a few. Therefore, the development of precedent on this issue is best left to case-by-case adjudication. I am writing separately, however, to clarify my interpretation of one portion of the order.

2. Paragraph 67 of the order justifies the inclusion of the due diligence defense on the ground that it provides a seller with the opportunity to present evidence relevant to the issue of intent. Paragraph 67 then notes that the existence of procedures designed to ensure accurate reporting would support a conclusion that any false submission was inadvertent and, thus, not a violation. I agree with this statement, but wish to make clear that it is only one example of the application of the due diligence defense. As the order notes, intent is a necessary element of any violation of Market Behavior Rule 2(b), 2(c), or 3. Moreover, it is the seller's intent that ultimately concerns us under these Rules, rather than the intent of individual staff. Therefore, I do not intend to hold a duly diligent seller liable for the intentional actions of a rogue trader. Paragraph 68 states that the due diligence standard is not intended to bar the consideration of evidence that an individual trader personally knew the submitted information was false. I agree that a complainant should be allowed to introduce evidence that an individual trader acted with intent in order to establish a prima facie case. However, the seller who then establishes that it exercised due diligence to prevent such actions should be absolved of liability, and the

state of mind of the individual trader should be irrelevant to the question of whether the seller did exercise due diligence.

Nora Mead Brownell

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations	Docket No. EL01-118-003

(Issued May 19, 2004)

KELLY, Commissioner, concurring and dissenting in part:

I strongly support the Commission's effort to adopt clearly-defined "rules of the road" in sellers' market-based rate tariffs and authorizations that specify anticompetitive behavior or other market abuses, and set out remedies for such market abuses. I am writing separately because I concur on the issue of the remedies outlined in this order and I dissent regarding the statement in P 45 of this order that violations of the Market Behavior Rules could not be used "to support or justify the abrogation of a contract, unless the rule violation at issue has a direct nexus to contract formation and thus tainted the contract itself."

Remedy

This order appropriately upholds the determination in the Market Behavior Rules Order that a seller violating these rules would be subject to remedies, which include disgorgement of unjust profits, suspension or revocation of the seller's authority to sell at market-based rates or other appropriate non-monetary remedies. However, I do not believe that the Commission should exclude a make-the-market-whole remedy as a possible monetary remedy for violations of the Market Behavior Rules.[1]

Contract Reformation or Abrogation

I dissent from this order to the extent that it provides that any party seeking contract reformation or abrogation under FPA section 206 based on a violation of one or more of the Market Behavior Rules is limited to those circumstances where

[1] The Commission accepted a make-the-market-whole remedy in a settlement with Reliant regarding physical withholding from the California PX market. See Fact-Finding Investigation Into Possible Manipulation of Electric and Natural Gas Prices, 102 FERC ¶ 61,108 (2003).

the violation has a direct nexus to contract formation and has tainted the contract formation itself. I believe that imposing such a restriction on the circumstances that may give rise to a contract reformation or abrogation complaint, or the evidence that may be presented within the context of such a complaint, is inconsistent with FPA section 206. I believe such an *ex ante* restriction is unwarranted because the Commission should evaluate each complaint on an individual basis and consider all of the specific circumstances presented in each complaint.

For example, a seller may enter, in good faith, into a contract that bases the contract price on an electricity price index. At some point after the formation of that contract, the seller may engage in wash trades, a *per se* violation of Market Behavior Rule 2(a), in order to manipulate the electricity index price. The Commission should allow that evidence to be presented as part of a contract reformation or abrogation proceeding under FPA section 206, even though the rule violation does not have a direct nexus to the formation of the contract.

For these reasons, I concur and dissent in part on today's order.

	_____ Suedeen G. Kelly